



Schroders Emerging Markets Lens: Emerging Market Debt

Strategic Research Unit

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Marketing material for
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Summary

After strong performance in 2023, emerging market (EM) bonds have posted mixed performance so far this year. Continued strength in the US economy has seen Federal Reserve (Fed) rate cut expectations scaled down, and US bond yields have ticked higher. This backdrop has been supportive of the US dollar.

Hard currency emerging market debt (EMD):

- Hard currency sovereign bonds are flat year-to-date while corporates have posted a positive return. These figures mask some divergent performance between the high yield (HY) and investment grade (IG) sub-sectors (slides 4-5).
- The hard currency sovereign spread is in line with the historical median, but there is a contrast between the IG and HY sub-index spreads (slide 10).
- In corporate EMD, both the IG and HY corporate spreads are firmly below their historical median (slide 16).

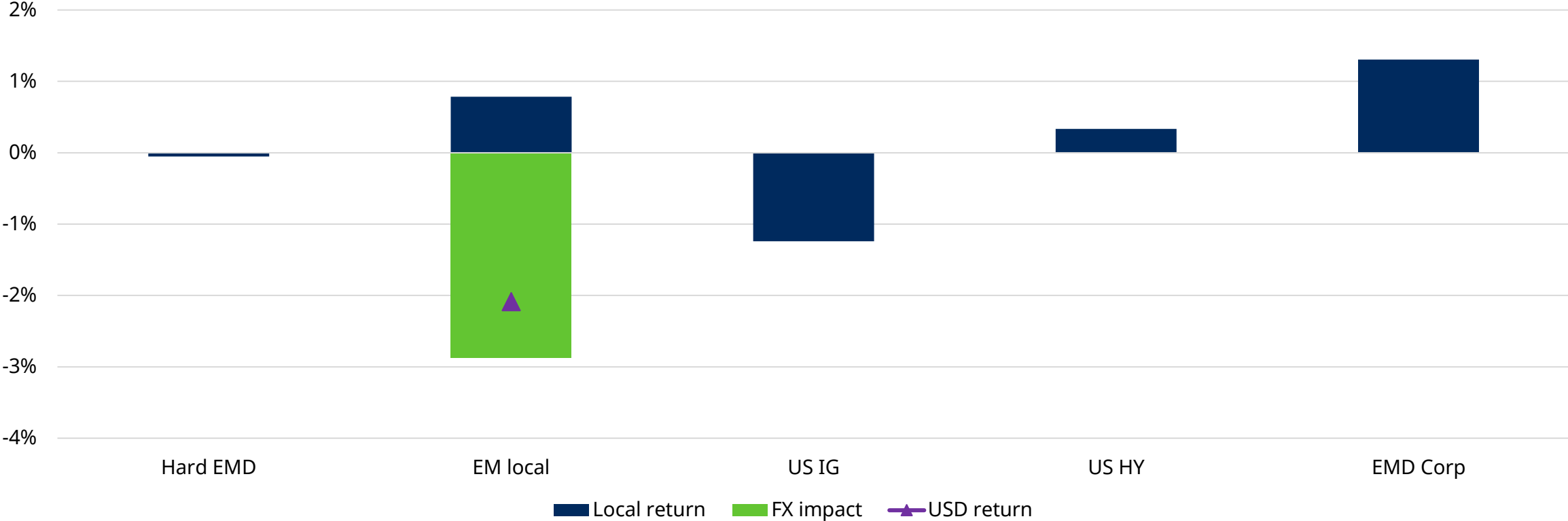
Local currency EMD:

- The average real yield premium of EM over DM has moved up from long term lows. Both the average EM and DM real yields have lifted, with EM well into positive territory again; the average DM real yield is still negative (slide 33).
- The average local EM ex Turkey yield curve is now upward sloping (slide 32).
- There are undervalued **currencies** in all three EM regions (slide 38), but the degree of value varies significantly.

EM bond performance has been mixed Year-to-date

EMD corporate leads, while EM local lags

Year-to-date, total return (USD)



but headline returns hide a shift in underlying EM hard currency performance

Past performance is not a guide to future performance and may not be repeated.

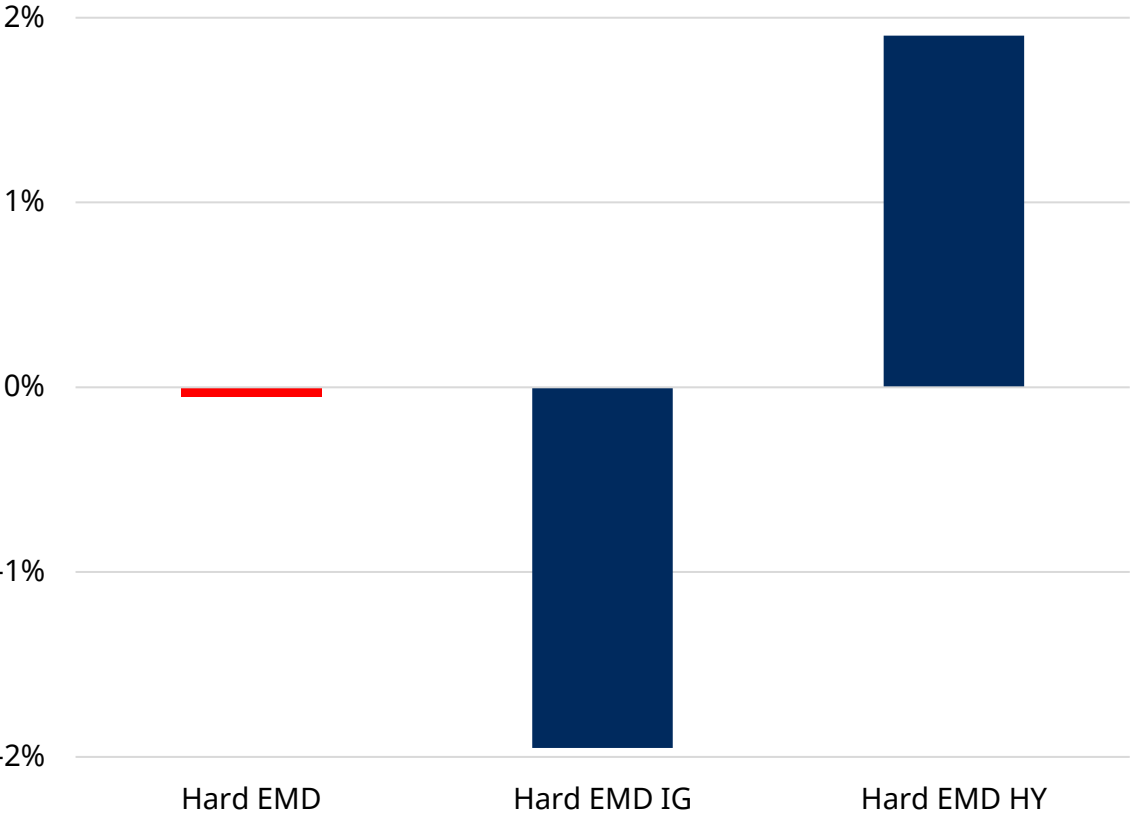
Note: Local currency = US dollar for all apart from local EMD which is in the relevant local EM currency.

Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

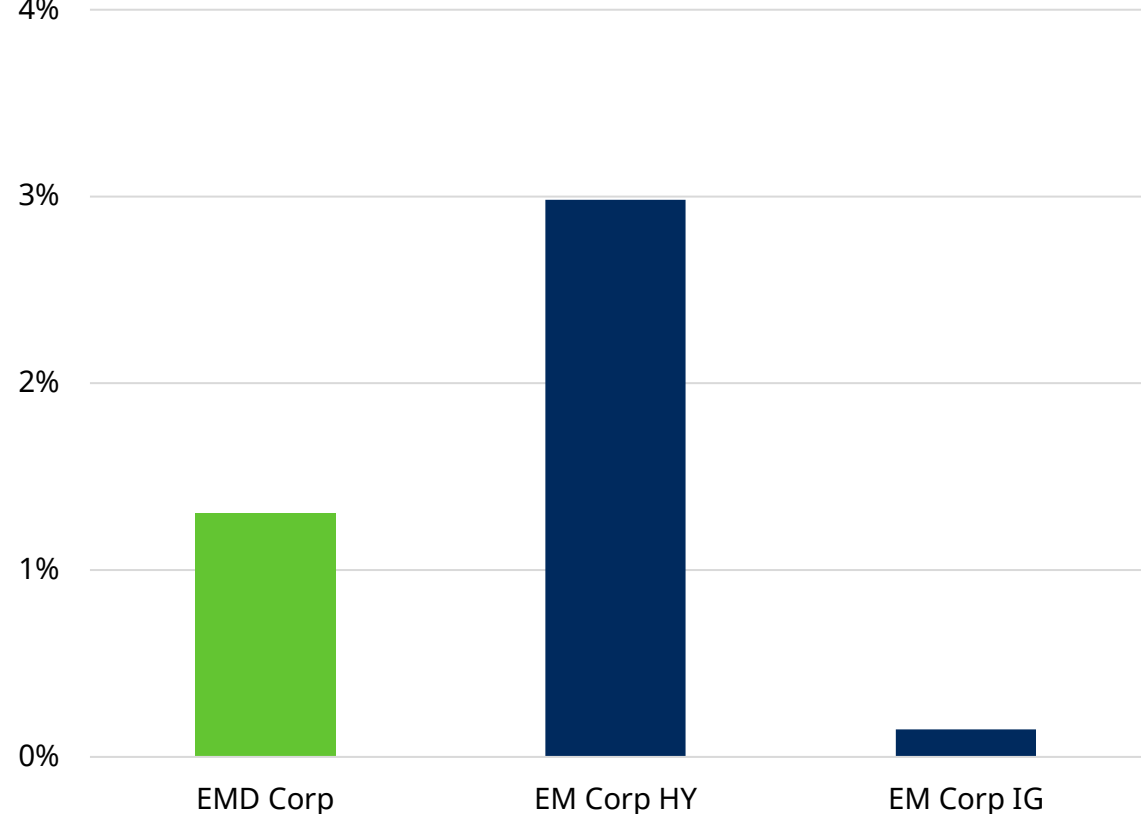
HY sub-indices underpin year-to-date performance

HY returns positive in sovereign and corporate hard currency; in contrast to IG...

HC sovereign, year-to-date total return (USD)



HC corporate year-to-date total return (USD)



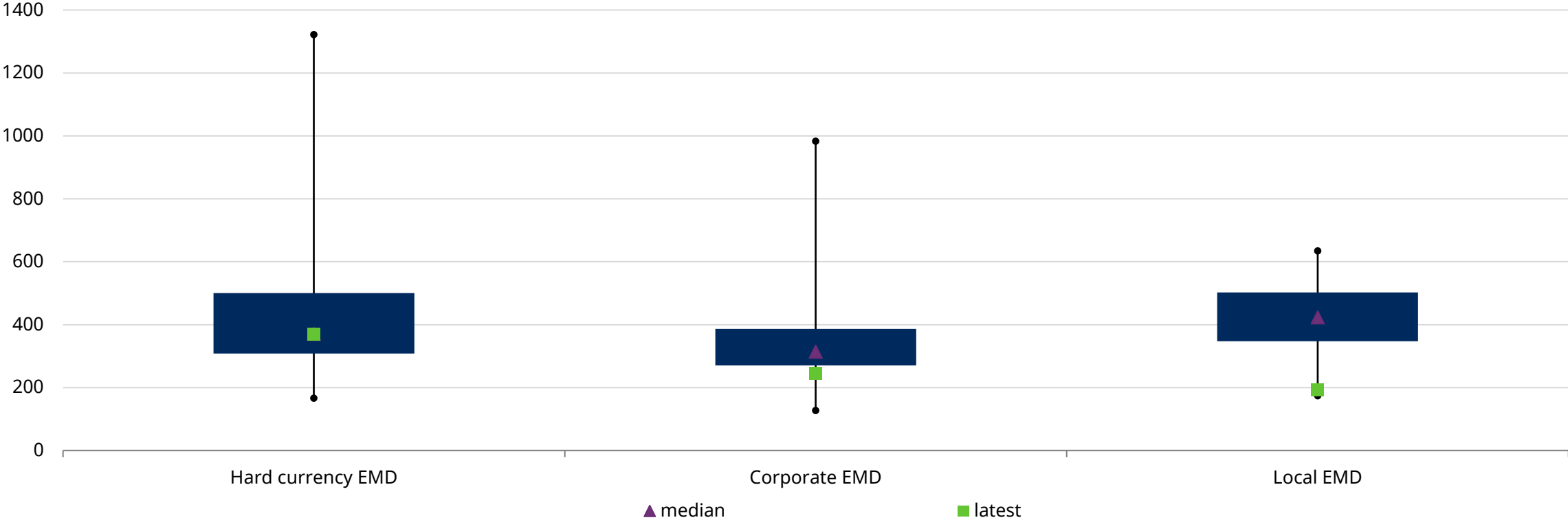
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Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

EMD headline valuations

Spread percentiles

Spreads of key EMD indices (basis points)



Hard currency valuations remain cheapest versus history, but there is more to this story (slides 11-12)

Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, LSEG Datastream, J.P. Morgan. Data as at 29 February 2024. Percentiles shows where the current spread is relative to the historical range of spreads, within a range of 0 to 100. The greater the percentile the higher the spread compared to history. Hard EMD =stripped spread, Local EMD =Spread to 5 year UST, Corporate EMD = spread to worst. Please see relevant disclaimers on page 43.



Emerging market debt:

Hard currency

Summary: hard emerging market debt

- Hard currency sovereign EMD advanced in February, bringing YTD performance close to flat. This hides divergent HY (+2%) and IG (-2%) sub-index performance. Within HY, performance has been led by more specific stories such as Egypt (+20%) and Argentina (+12%).
- The hard currency sovereign EMD index spread is in line with the historical median. Looking beneath this headline figure, the IG sub-index is well below its historical average while the HY index spread is above-median; even if it has been falling.
- Sovereign EMD spreads have trended down since Q4 2022, primarily driven by the HY component, but dispersion between countries remains wide. This is evident at the regional level; despite its small size, Africa is the second largest contributor to spread after Latin America.
- In corporate EMD, both the IG and HY corporate spreads are firmly below their historical median.
- Credit quality worsened in the pandemic and was compounded by the 2022 challenges for issuers included in major sovereign/corporate EMD benchmarks. However, net credit rating changes have now turned positive on 12-month unweighted basis.

Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

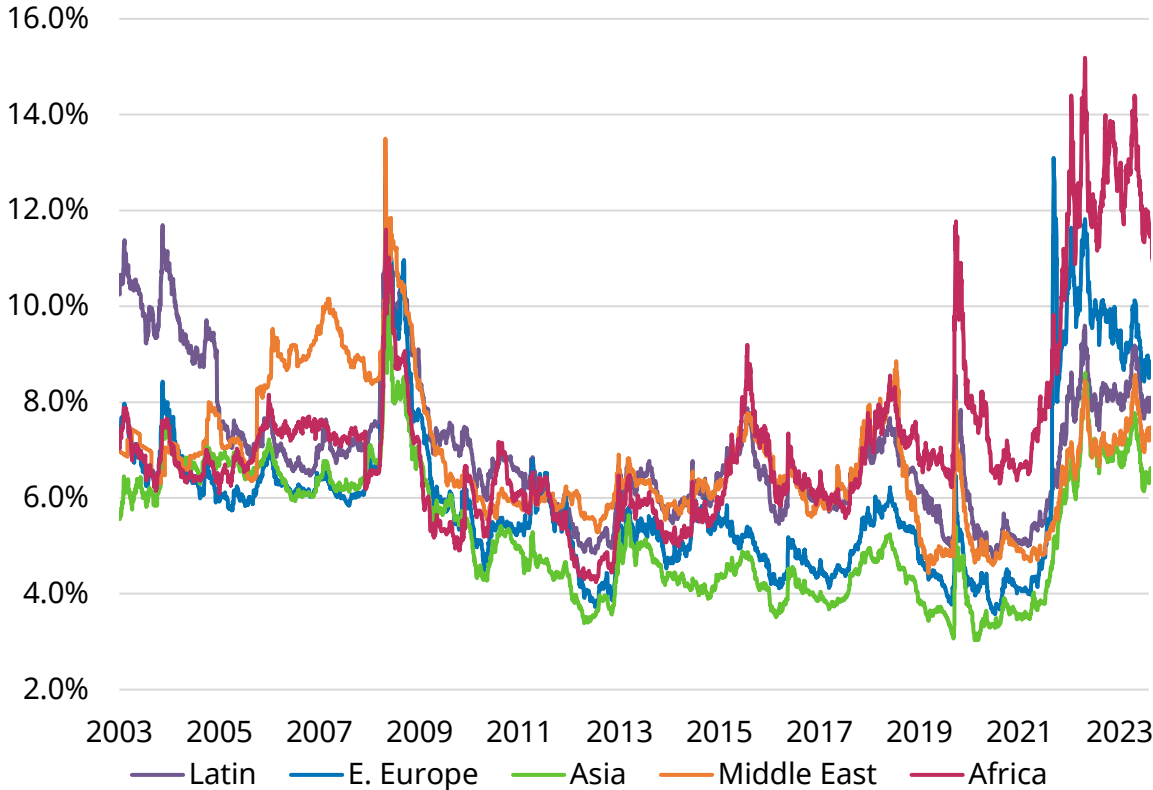
Hard EMD index yield well below 2023 peak

...but still very elevated when compared to the last 15 years

Hard currency sovereign EMD index yield



Hard currency sovereign EMD index yield by region



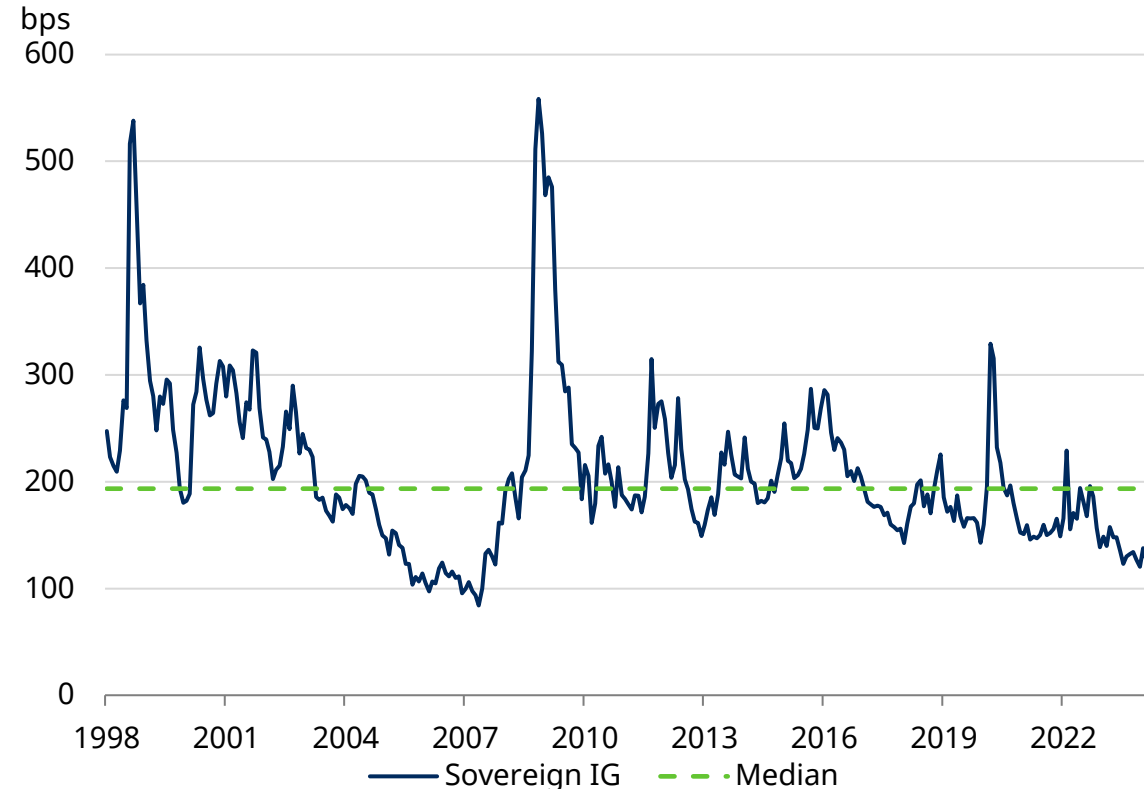
On a regional basis, yields are highest in Africa and Eastern Europe

Past performance is not a guide to future performance and may not be repeated.
Russia was removed from all JP Morgan EMD indices from 31 March 2022.
Source: Schroders, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

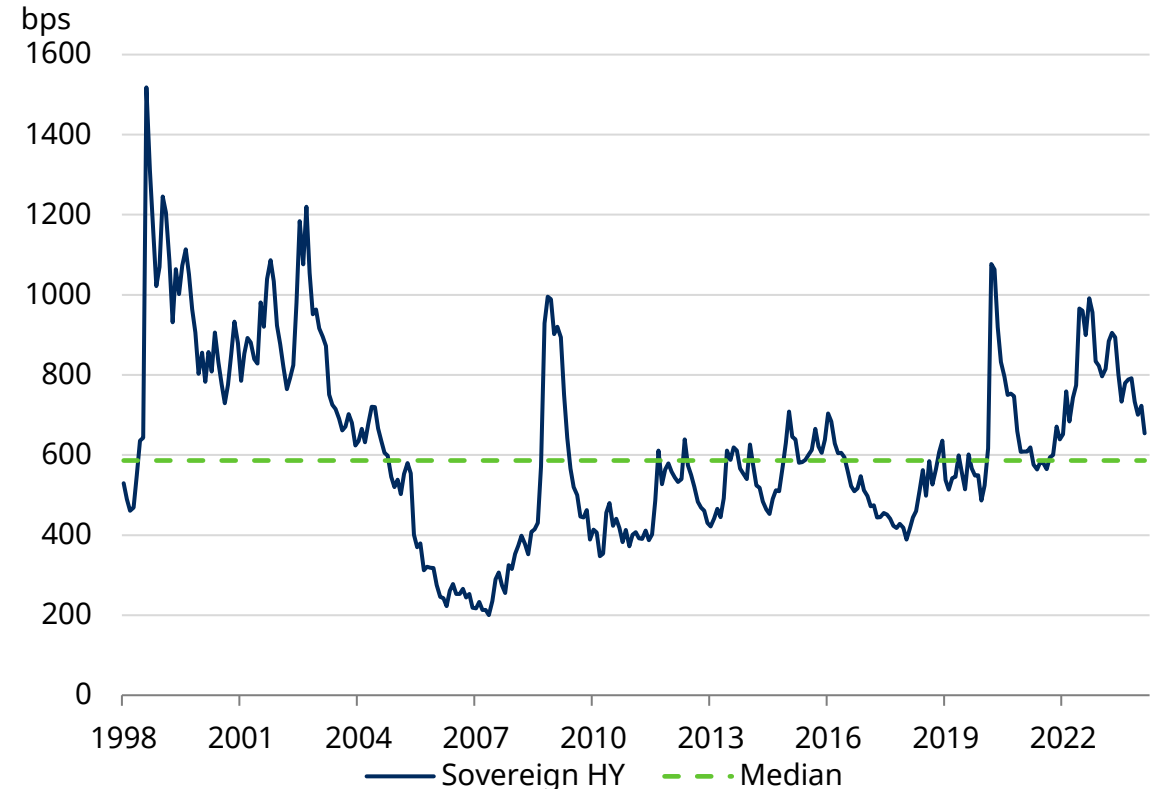
A contrasting picture in hard currency sovereign EMD...

IG spreads is close to post-GFC low, HY above historical median

Hard currency sovereign EMD IG spread



Hard currency sovereign EMD HY spread



...but HY spread continues to fall

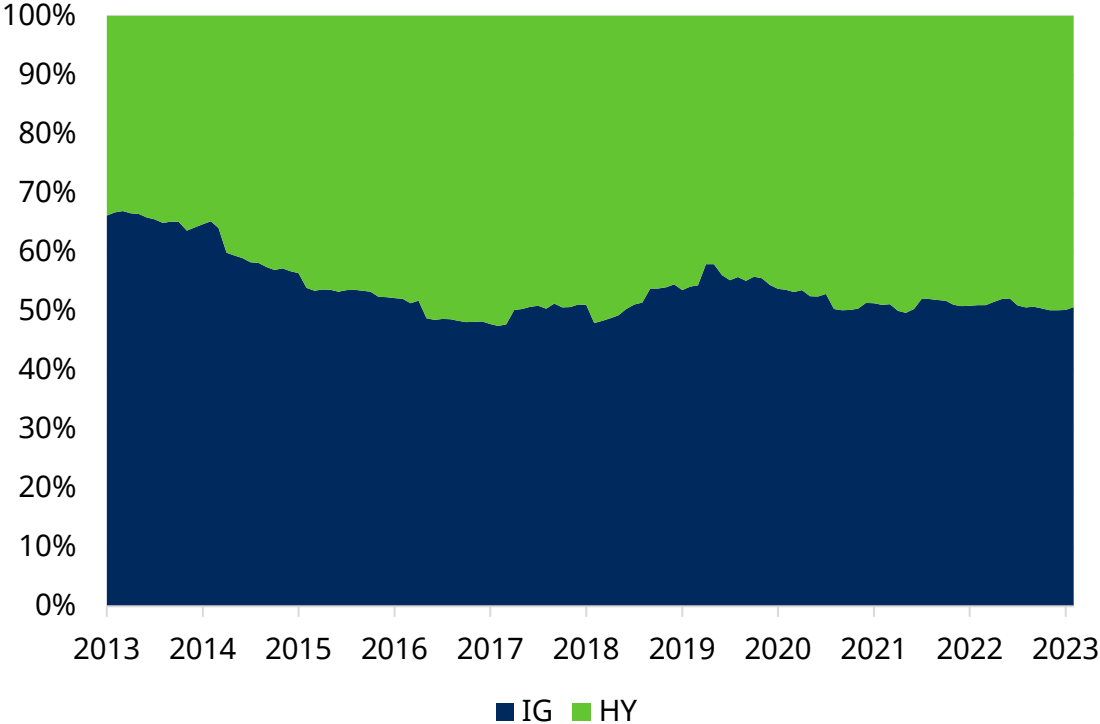
Past performance is not a guide to future performance and may not be repeated.

Source: LSEG Datastream, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

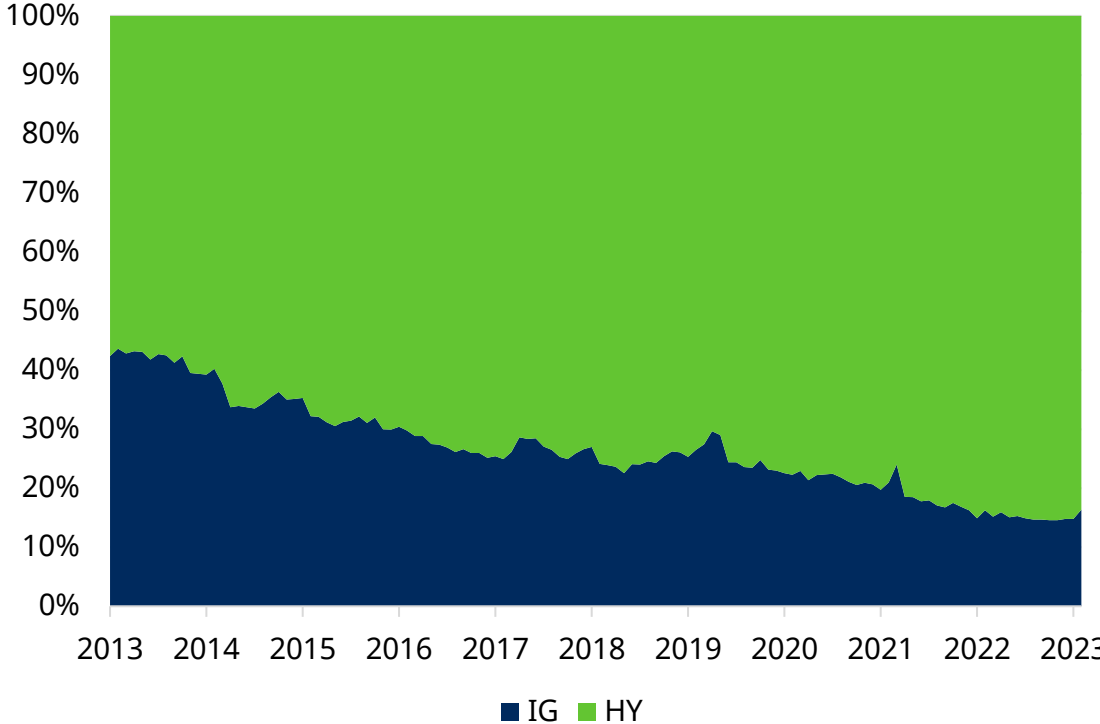
Hard currency spread increasingly driven by HY component

Despite HY and IG index weights remaining relatively stable over the past decade

HY and IG index weights relatively stable over time



HY share of spread contribution has increased

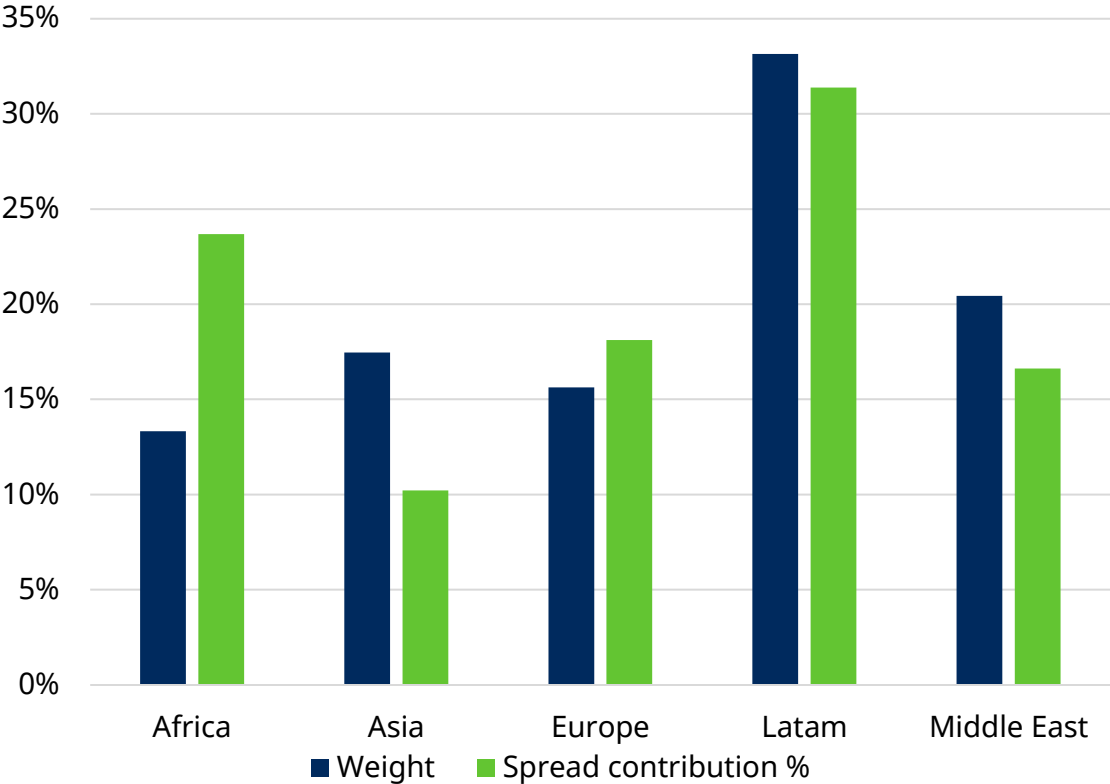


Source: LSEG Datastream, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43. Spread contribution calculated as HY spread multiplied by index weight, and equivalent for IG. Percentage contribution for IG and HY shown as share of total spread contribution (IG and HY).

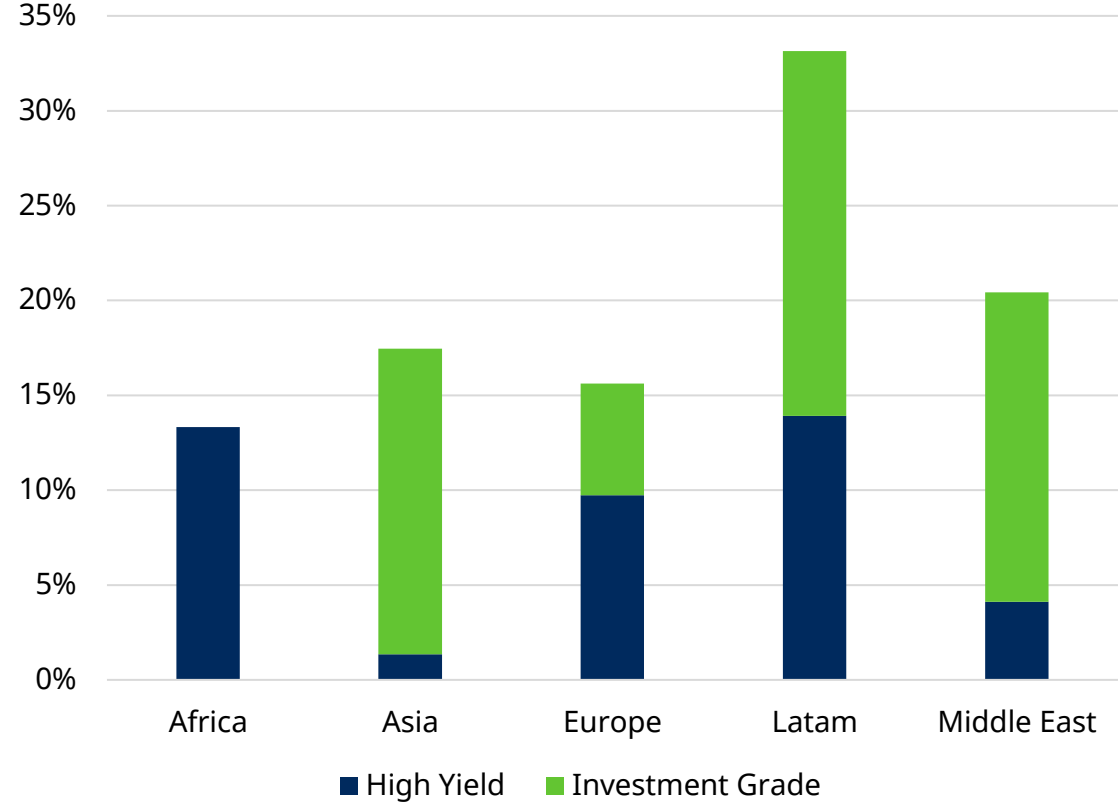
Latin America dominates the sovereign hard currency index

But Africa punches well above its weight when it comes to spread contribution...

Hard currency index weights and spread contributions



Hard currency weights split by HY/IG



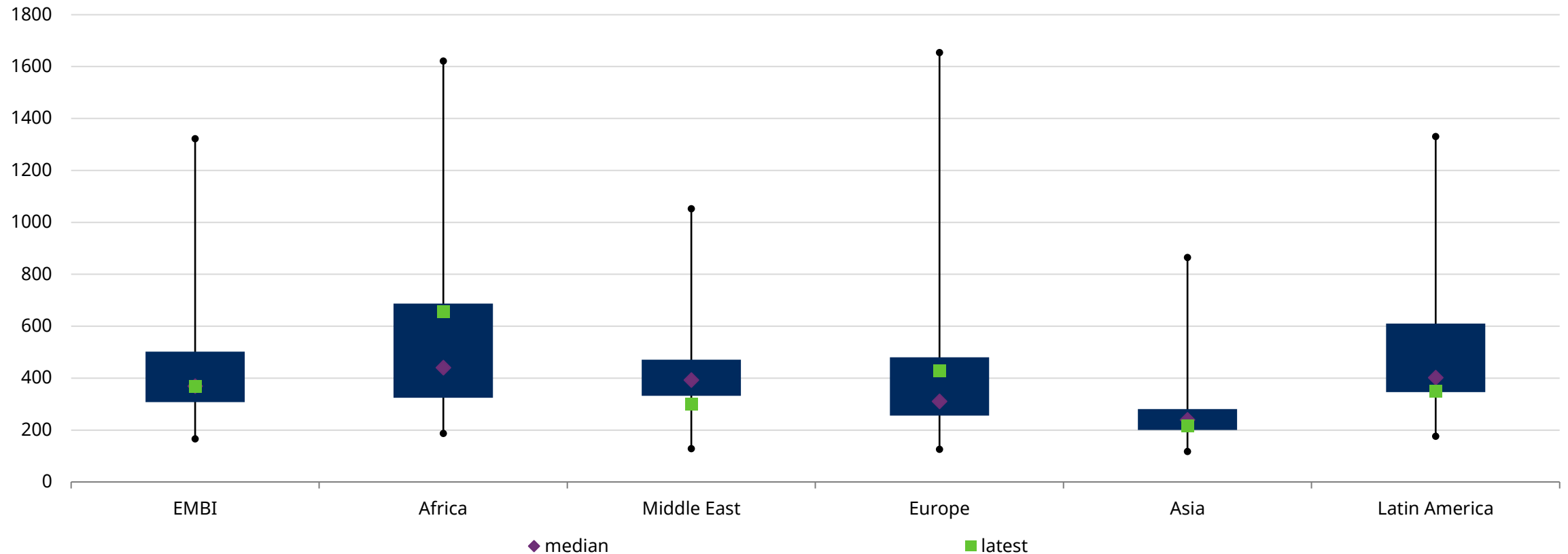
This is explained by the fact that Africa is all HY; Asia/Middle East is largely IG and LatAm more balanced

Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43. Spread contribution calculated as weight of the region multiplied by the spread of that region. IG/HY split Schroders calculation.

Where are the cheap valuations in hard currency EMD?

Africa and Europe offer the highest spreads versus history

Spreads of key regional hard currency EMD indices (basis points)



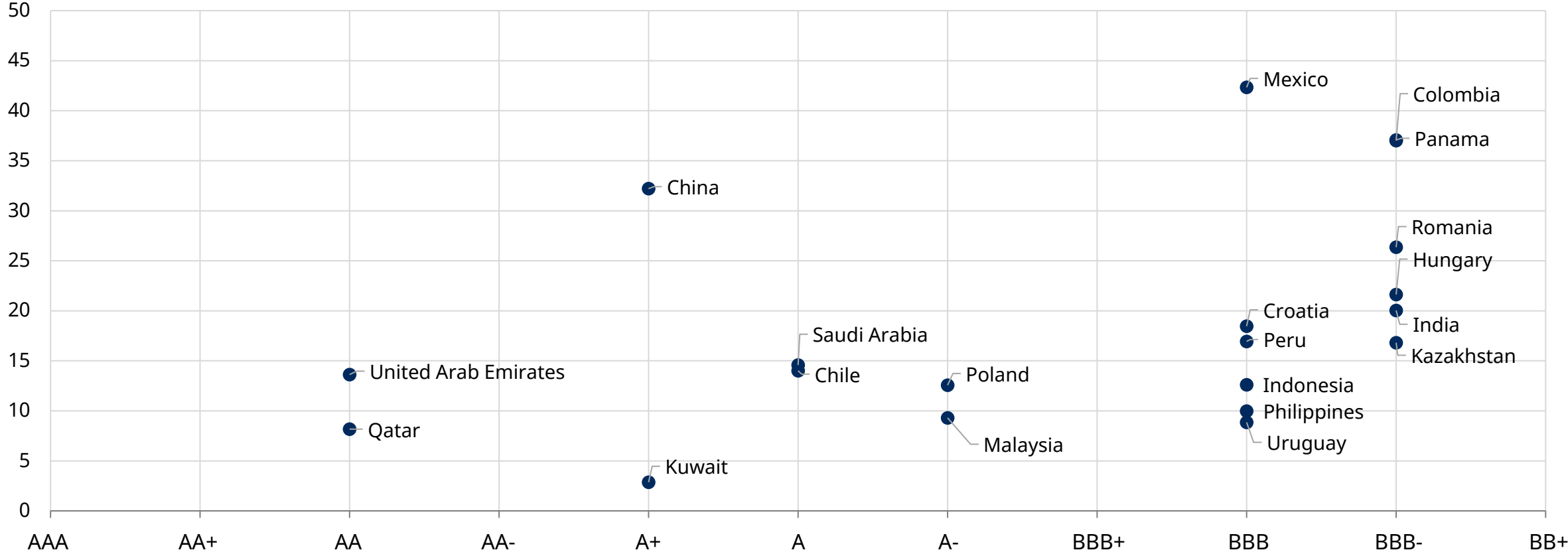
Past performance is not a guide to future performance and may not be repeated.

Percentiles shows where the current stripped spread is relatively to the historical range of spreads, within a range of 0 to 100. The greater the percentile the higher the spread compared to history.

Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

Duration adjusted spreads of IG countries

Hard currency sovereign EMD IG: spread vs. duration vs. credit rating

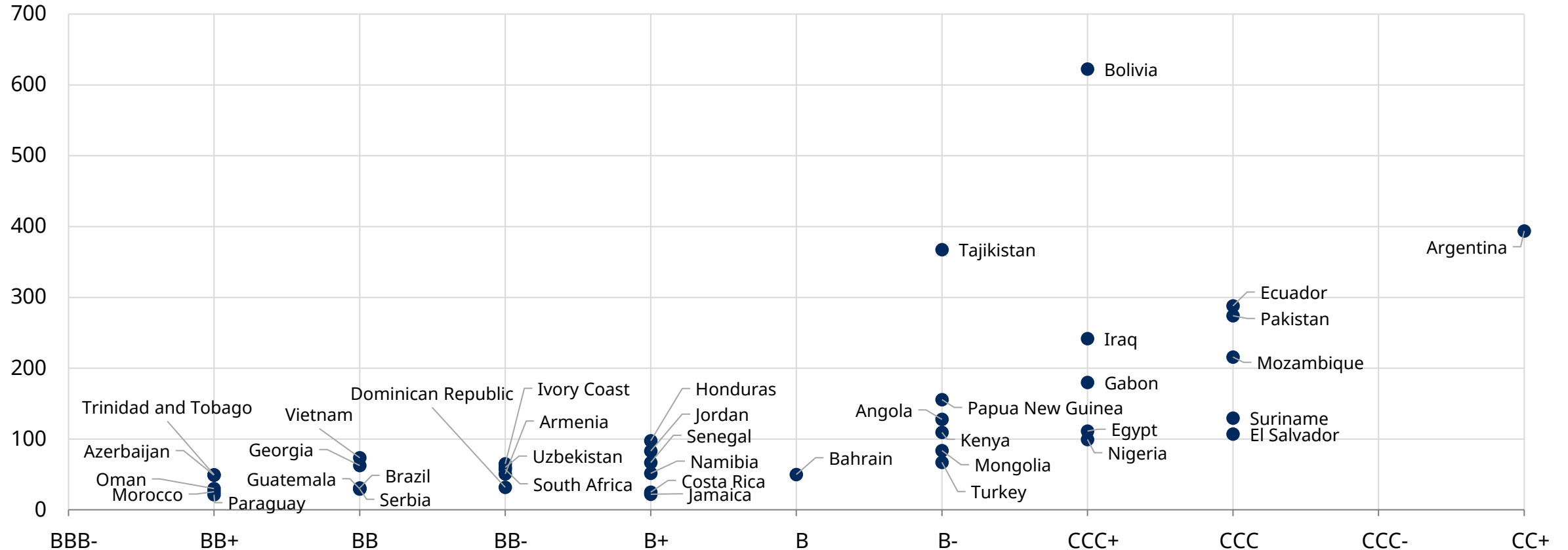


¹The JPMorgan EMBI Global Diversified Index includes both sovereign and quasi-sovereign bonds.
 The y-axis shows spread per unit of duration, in basis points.
 Source: Schroders, LSEG Datastream, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

Duration adjusted spreads of HY countries

Significant variability between the countries

Hard currency sovereign EMD HY: spread vs. duration vs. credit rating

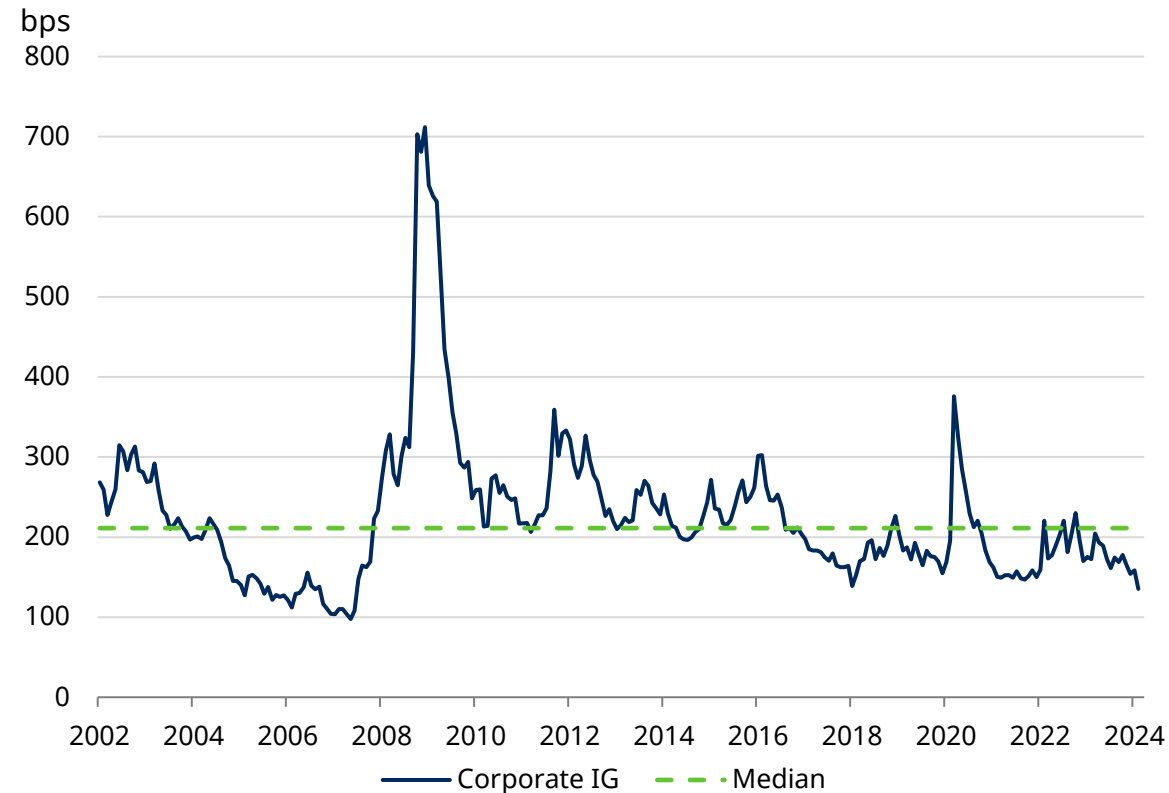


The y-axis shows spread per unit of duration, in basis points.
 Source: Schroders, LSEG Datastream, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

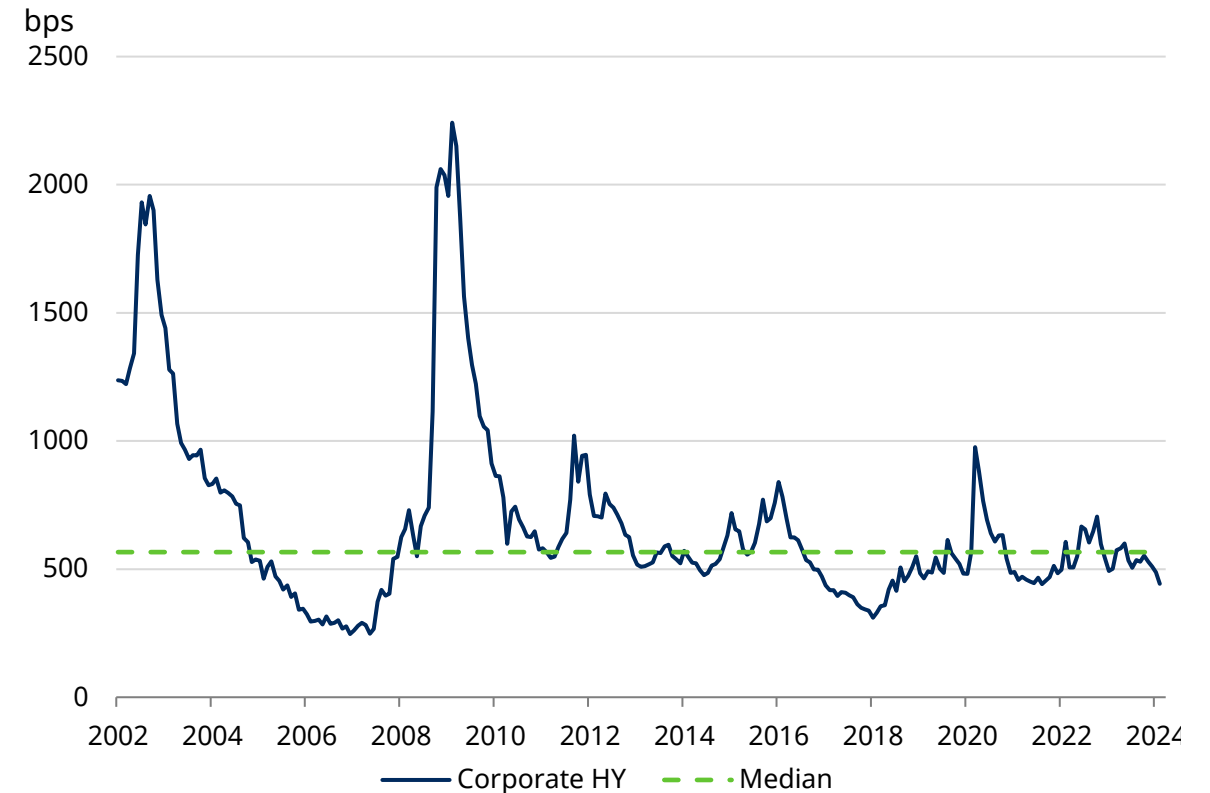
Valuation of hard currency corporate EMD

The IG and HY corporate spreads are firmly below the historical median

Hard currency corporate EMD IG spread



Hard currency corporate EMD HY spread



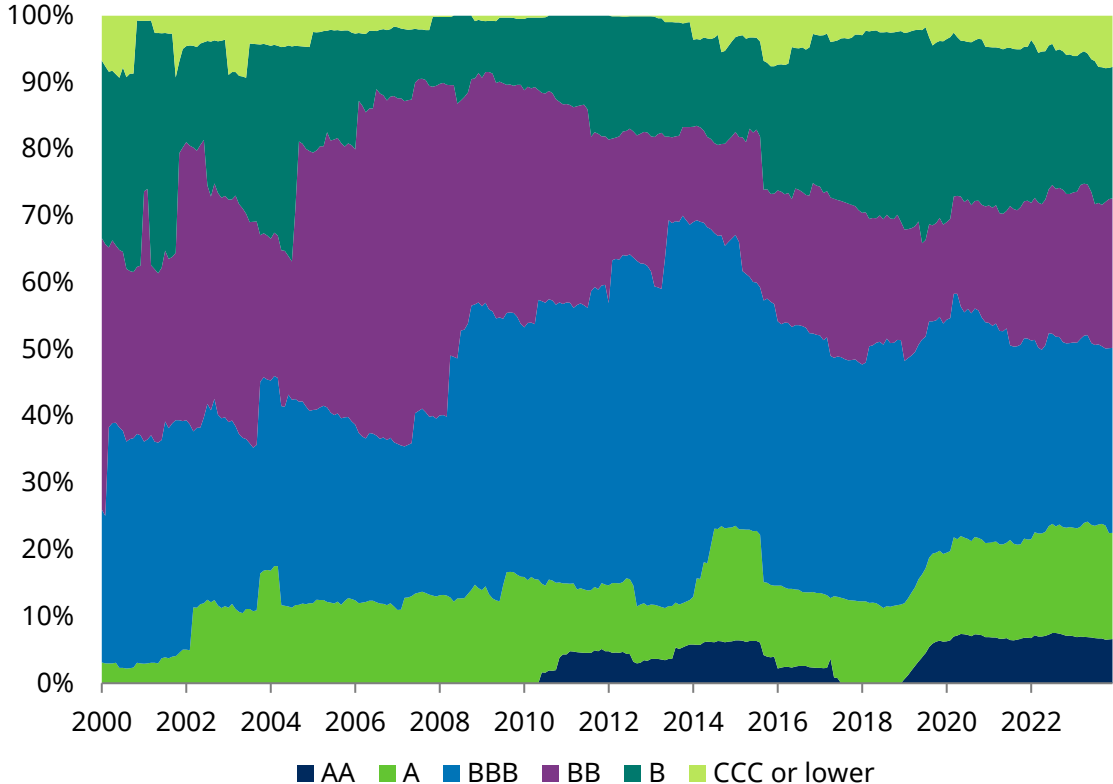
Past performance is not a guide to future performance and may not be repeated.

Source: LSEG Datastream, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

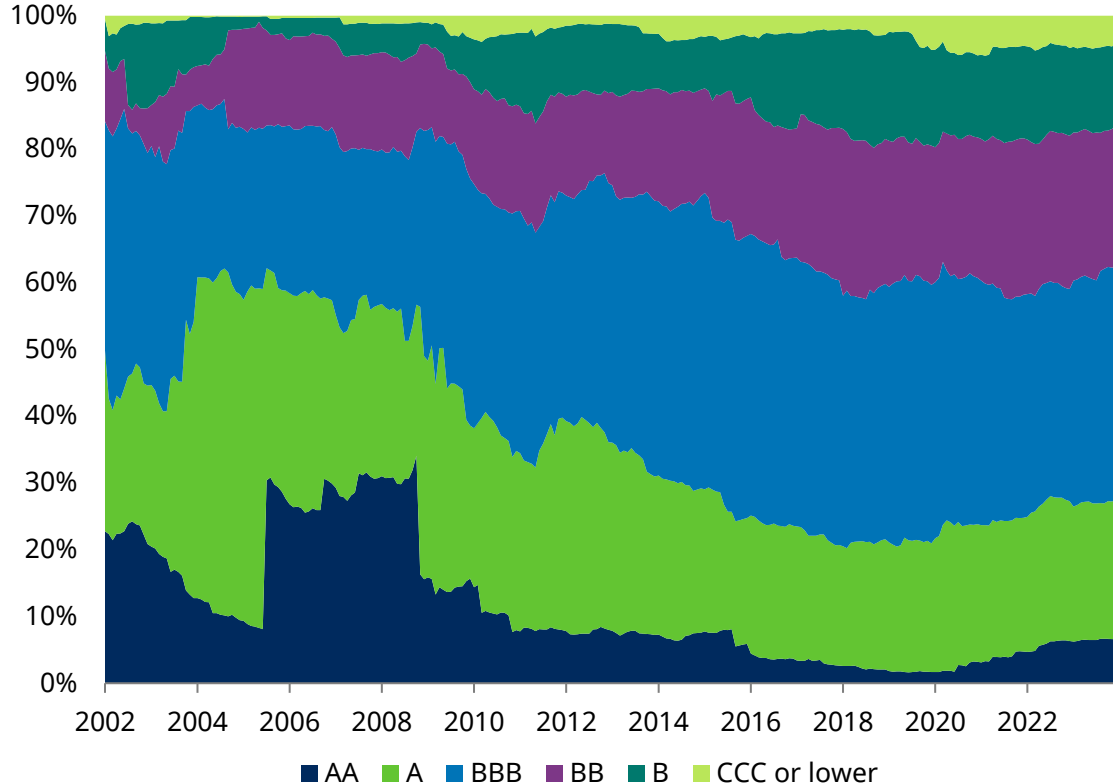
EMD historical ratings split

Share of IG bonds has fallen in the sovereign and corporate indices in the last decade

Sovereign EMD ratings split



Corporate EMD ratings split

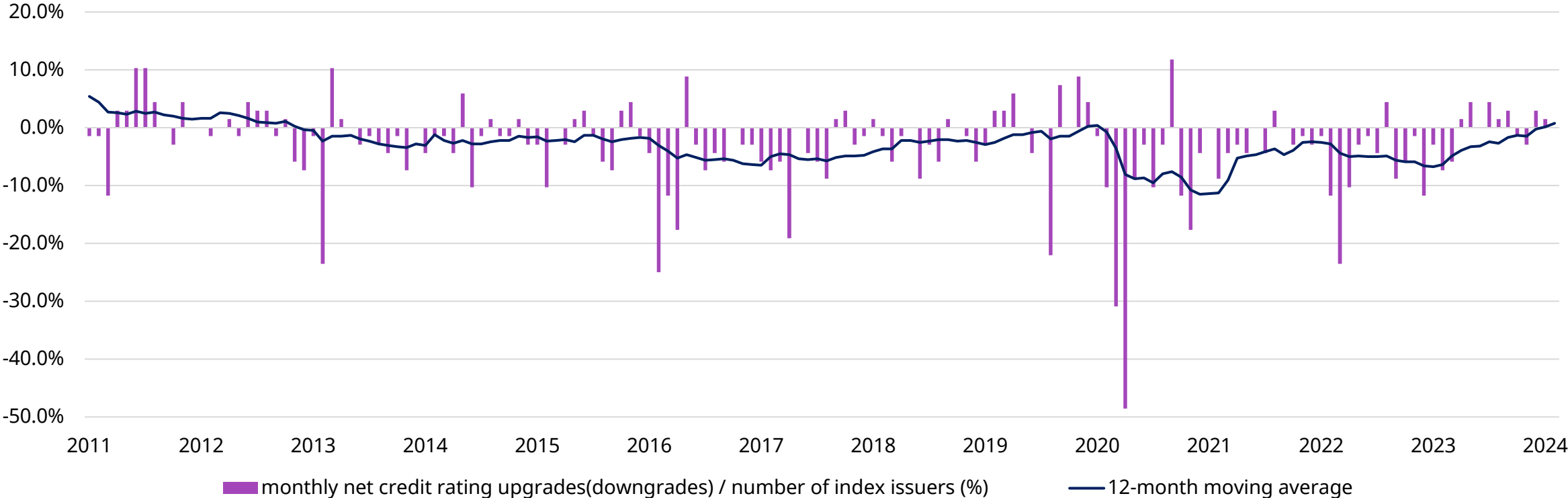


Past performance is not a guide to future performance and may not be repeated
 Source: Schroders, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

Net credit rating changes have turned positive

The number of issuers receiving upgrades exceeds downgrades over last 12-months

Sovereign hard currency index net credit rating upgrades/downgrades



Only the second time in the past decade that the 12-month average has been positive

Past performance is not a guide to future performance and may not be repeated.
Weighted by number of issuers, not size of issuer.
Source: Schroders, Bloomberg. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

Characteristics of EM hard currency issuers

Hard currency corporate issuers



■ Financials ■ Nonfinancials

Hard currency sovereign issuers



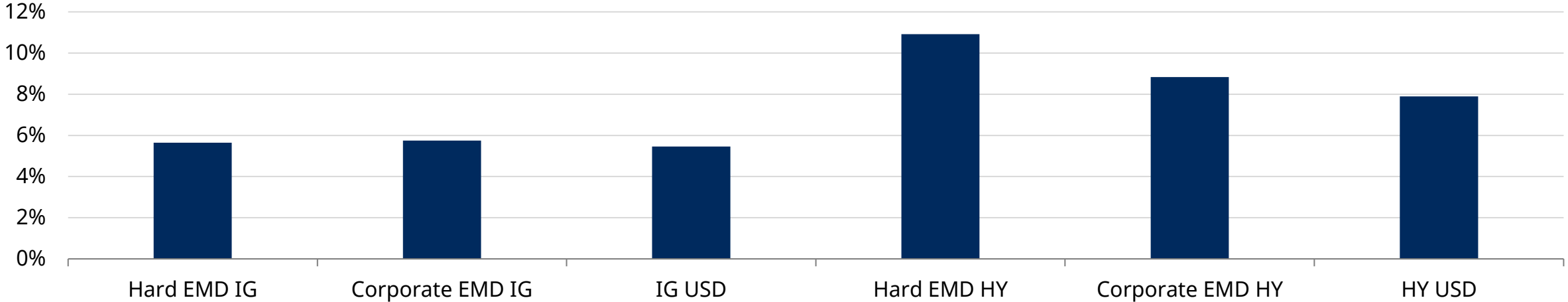
■ Sovereign ■ Quasi Sovereign

Source: LSEG Datastream, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

Hard and corporate EMD offer a yield and spread pick-up over equivalent rated US corporate debt

	Hard EMD IG	Corporate EMD IG	IG USD	Hard EMD HY	Corporate EMD HY	HY USD
Yield	5.6%	5.7%	5.5%	10.9%	8.8%	7.9%
Spread (bps)	125	136	100	654	444	329
Duration	7.7	4.8	6.9	5.5	3.3	4.1
Rating	A3	A3	A3	B1	B1	B1
Percentage of EMD index	49.6%	58.9%	-	50.4%	41.1%	-

EM vs. DM yields

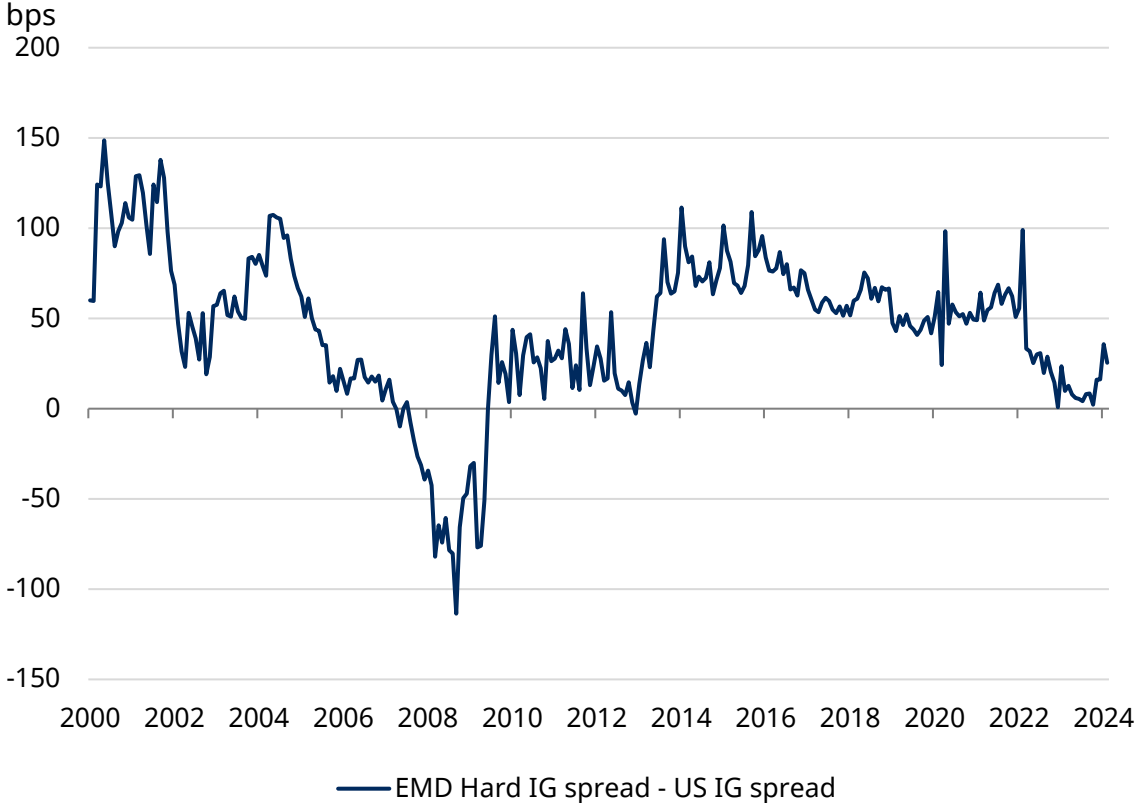


Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

EM dollar debt: sovereign EMD vs. US corporates

Sov. EMD HY spread premium to US HY narrowing as EM spreads fall faster than US

Sovereign EMD IG spread minus US IG spread



Sovereign EMD HY spread minus US HY spread



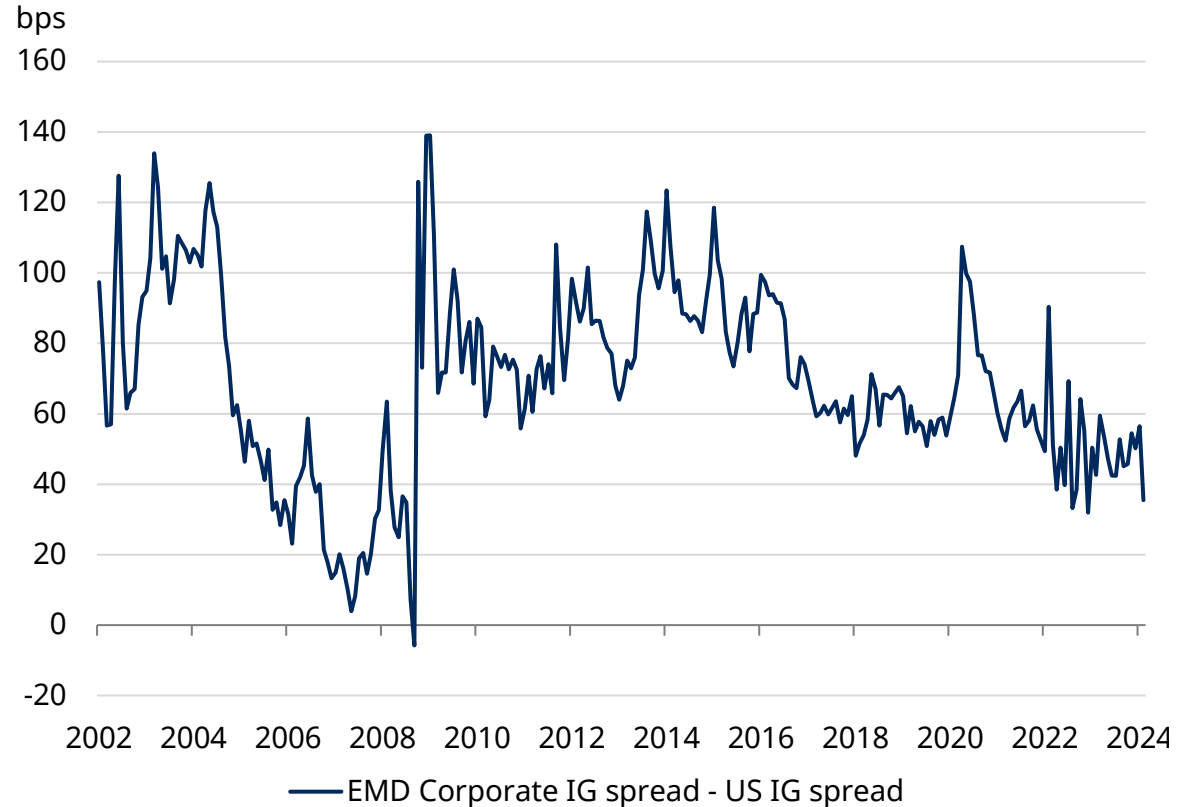
...but EM HY spread premium remains elevated versus history

Past performance is not a guide to future performance and may not be repeated.
Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

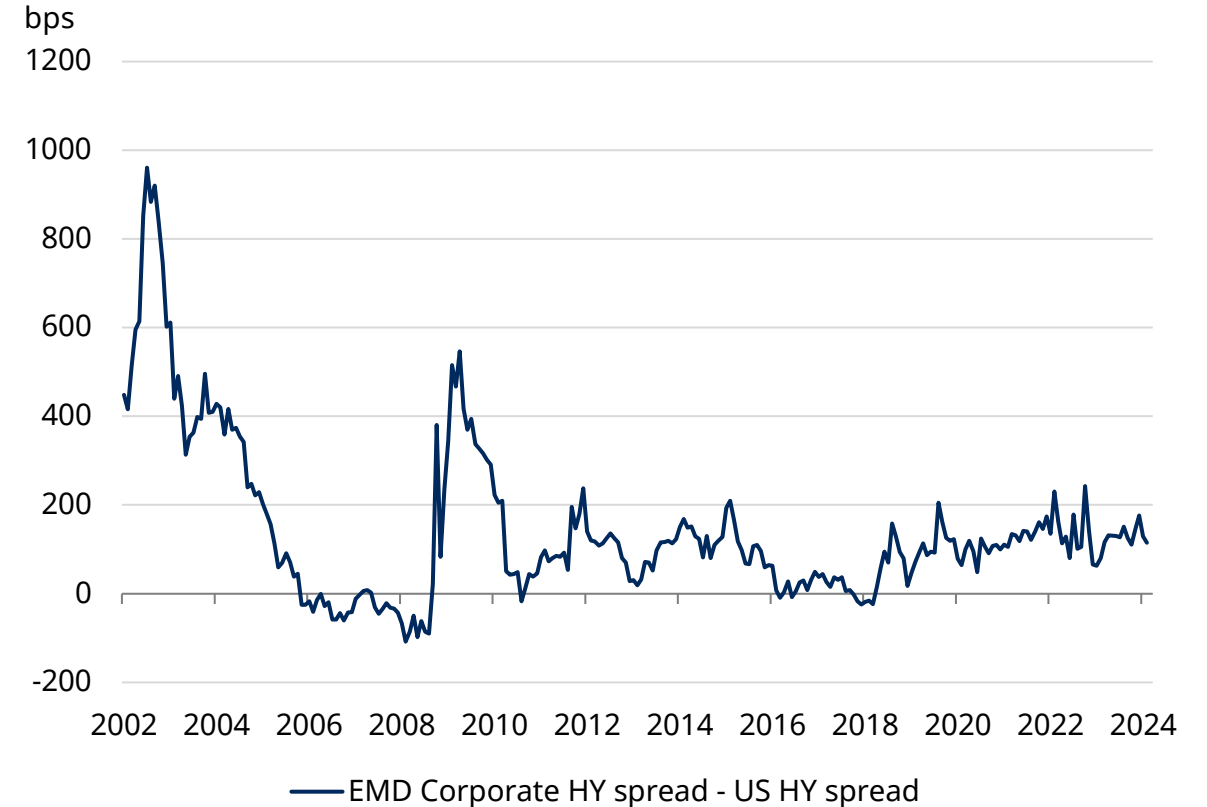
EM dollar debt: corporate EMD vs. US corporates

EM Corp IG and HY spread premia to US both narrowing YTD

Corporate EMD IG spread minus US IG spread



Corporate EMD HY spread minus US HY spread



Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.



Emerging market debt:

Local currency

Summary: local currency emerging market debt

- Local EM bonds have been under pressure year-to-date, with US dollar strength the key drag.
- The yield on the local EM bond index has been stable year-to-date, but there remains significant variation between regions. Yields in Latin America are markedly higher than in EM Asia.
- EM ex Turkey inflation continues to fall. After a solid decline in 2023, headline rates in most EM are at or moving towards target. Interest rate cuts are underway in various markets, led by Latin America.
- Turkey is the exception, where a renewed vein of orthodoxy saw the central bank hike its policy rate by almost 37 percentage points between June and January 2024.
- The average local EM ex Turkey yield curve is now upward sloping.
- The average real yield premium of EM over DM has moved up from long term lows. Both the average EM and DM real yields have lifted, with EM well into positive territory again; the average DM real yield is still negative.

Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

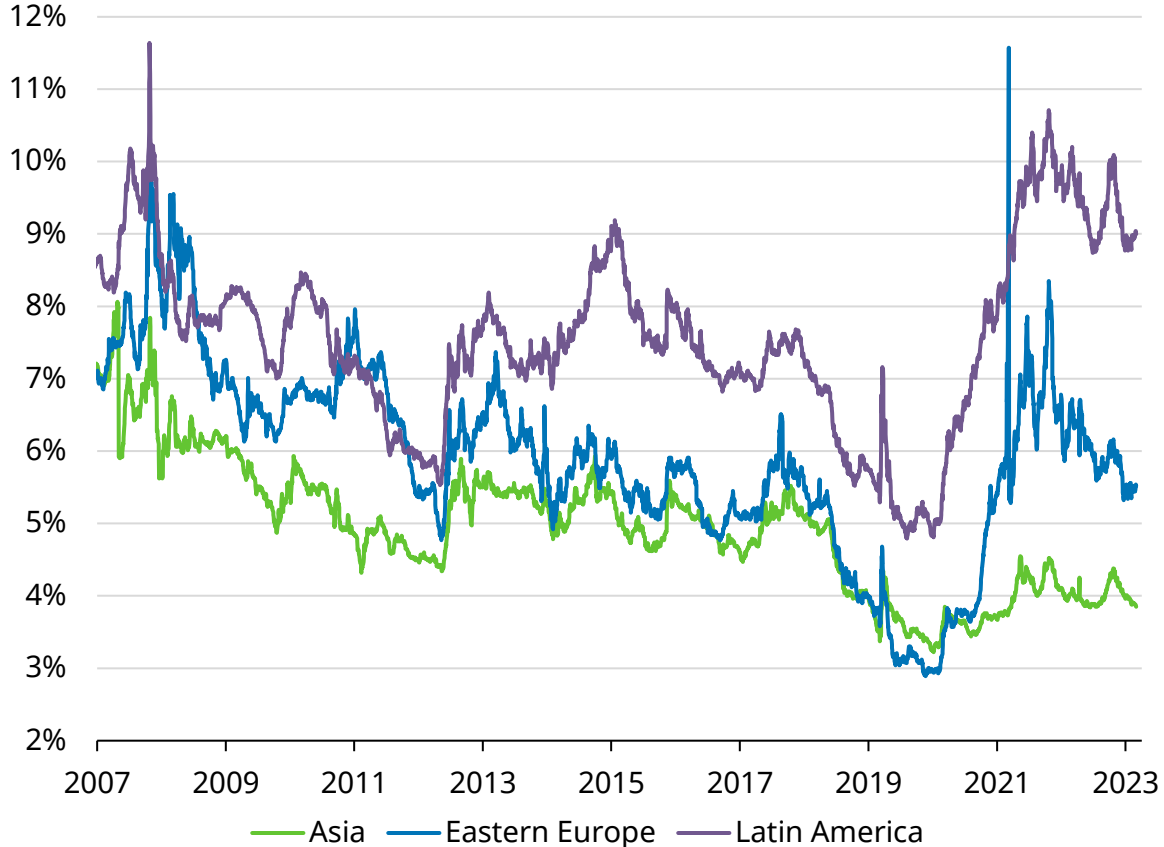
EM local currency index yield has been stable year-to-date

Yields vary widely by region, but are notably higher in Latin America

Local EMD index yield



Local EMD yield by region



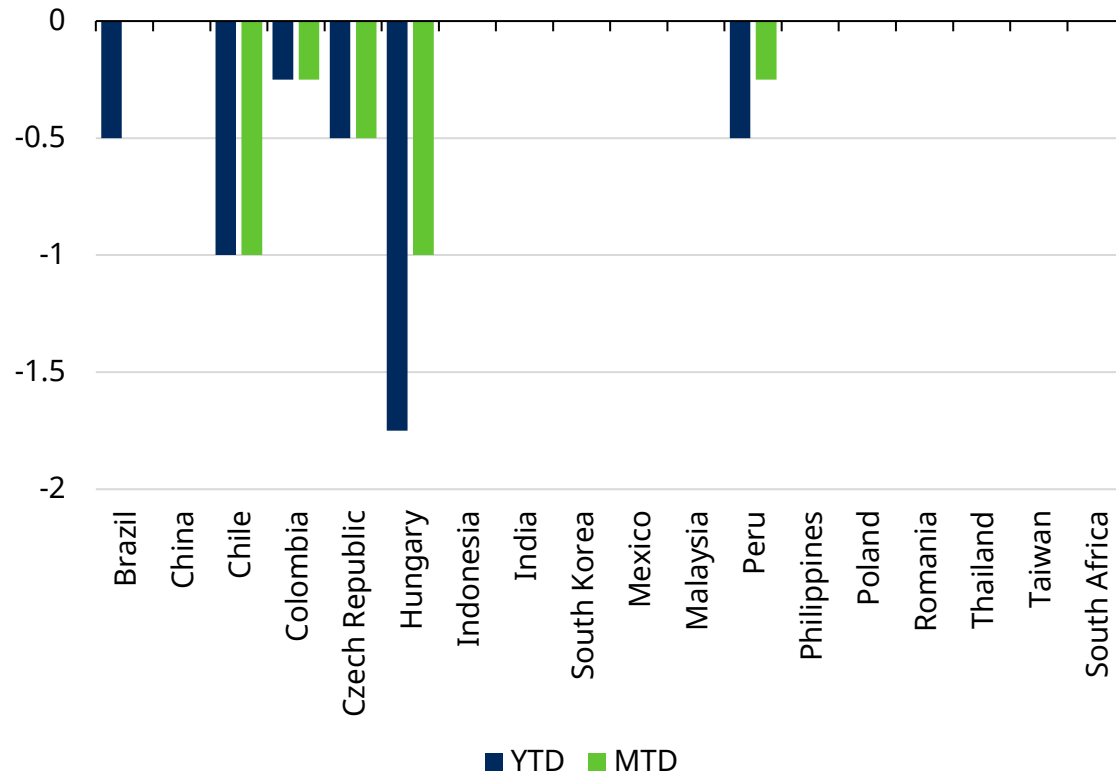
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Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Russia was removed from all JP Morgan EMD indices from 31 March 2022. Please see relevant disclaimers on page 43.

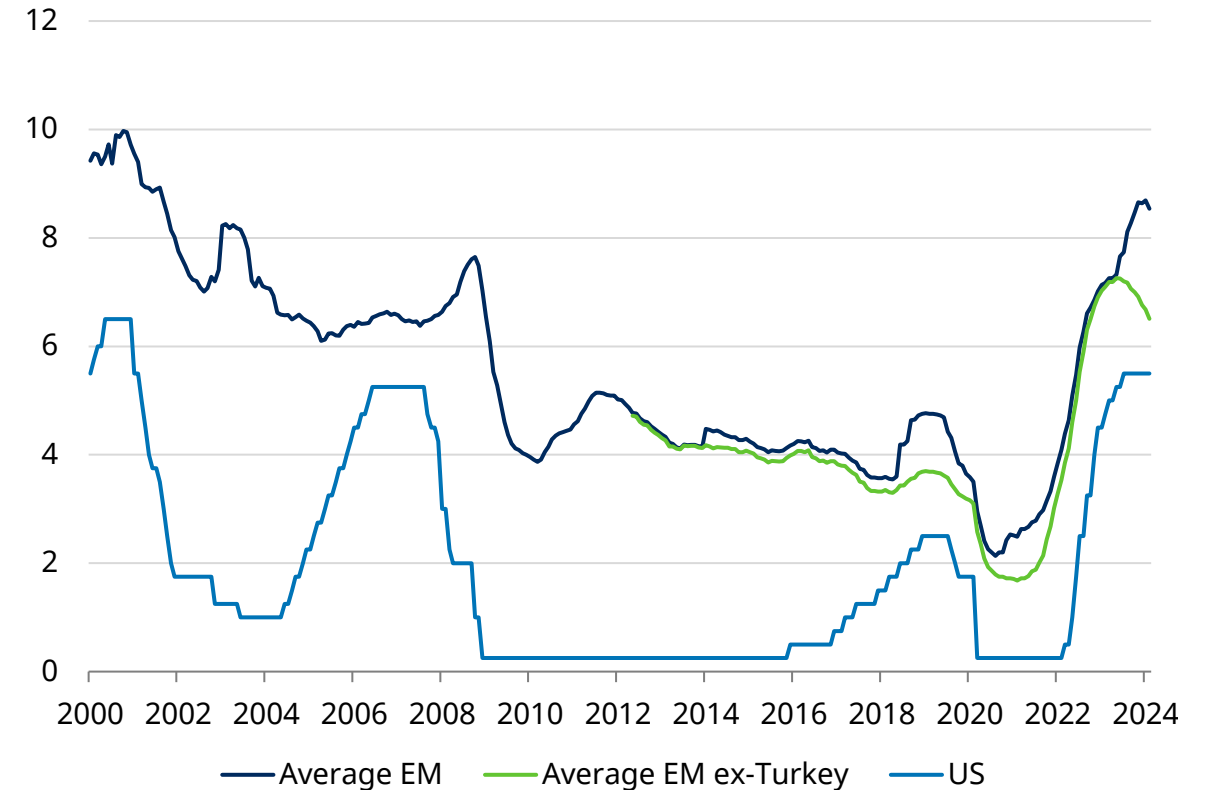
EM ex Turkey policy rates are falling

EM central banks have begun easing cycles...

Change in EM policy rates MTD/YTD(%)*



Average EM policy rate¹ (%)



Central banks in Latin America leading the way with rate cuts, given greater scope to ease

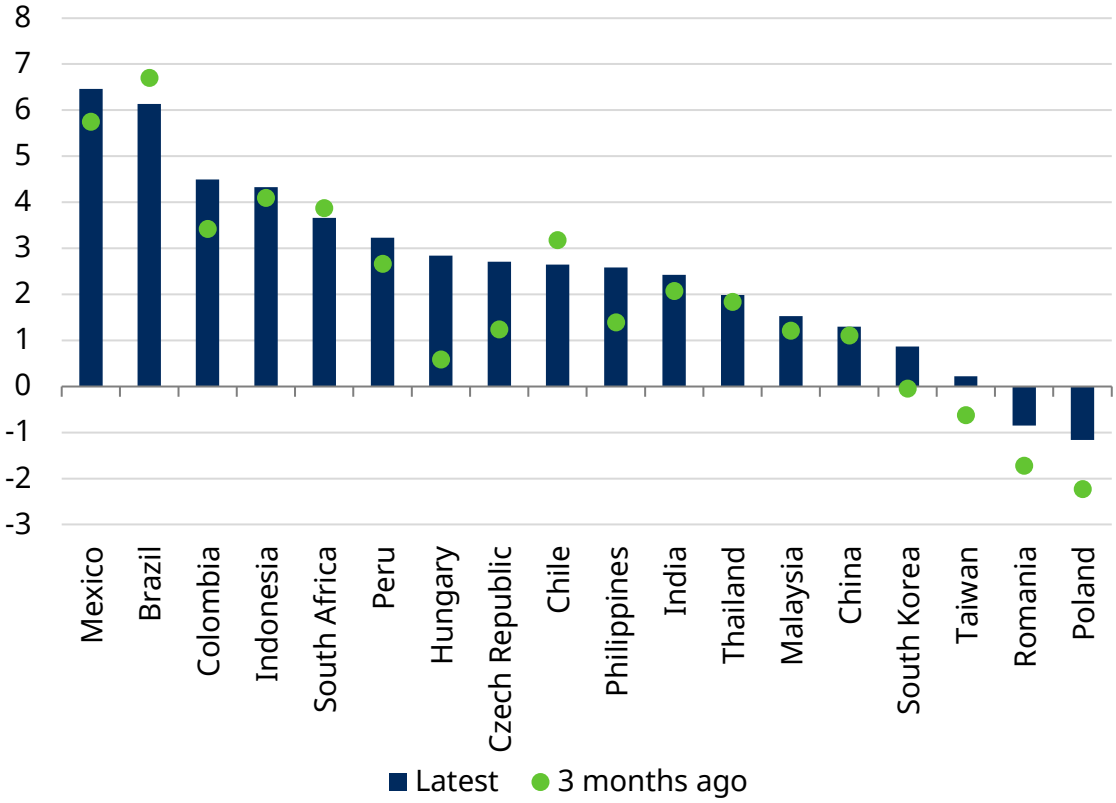
Source: Schroders, LSEG Datastream. Data as at 29 February 2024. ¹Based on 19 major EM countries. Please see relevant disclaimers on page 43.

*Turkey is excluded from the bar chart due to scale of hikes compared to the rest of EM.

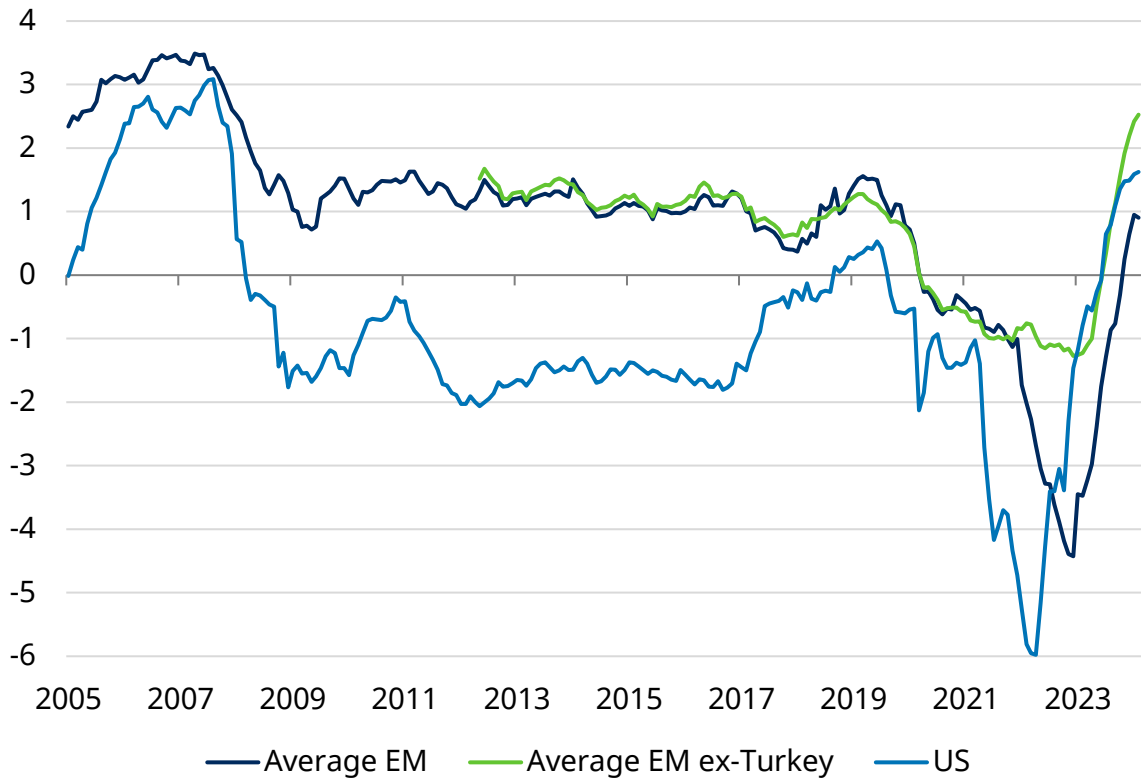
Majority of EM real policy rates have turned positive

Some Eastern Europe real rates have lagged, but are catching up

EM real policy rates (%)



Average EM real policy rate¹ (%)



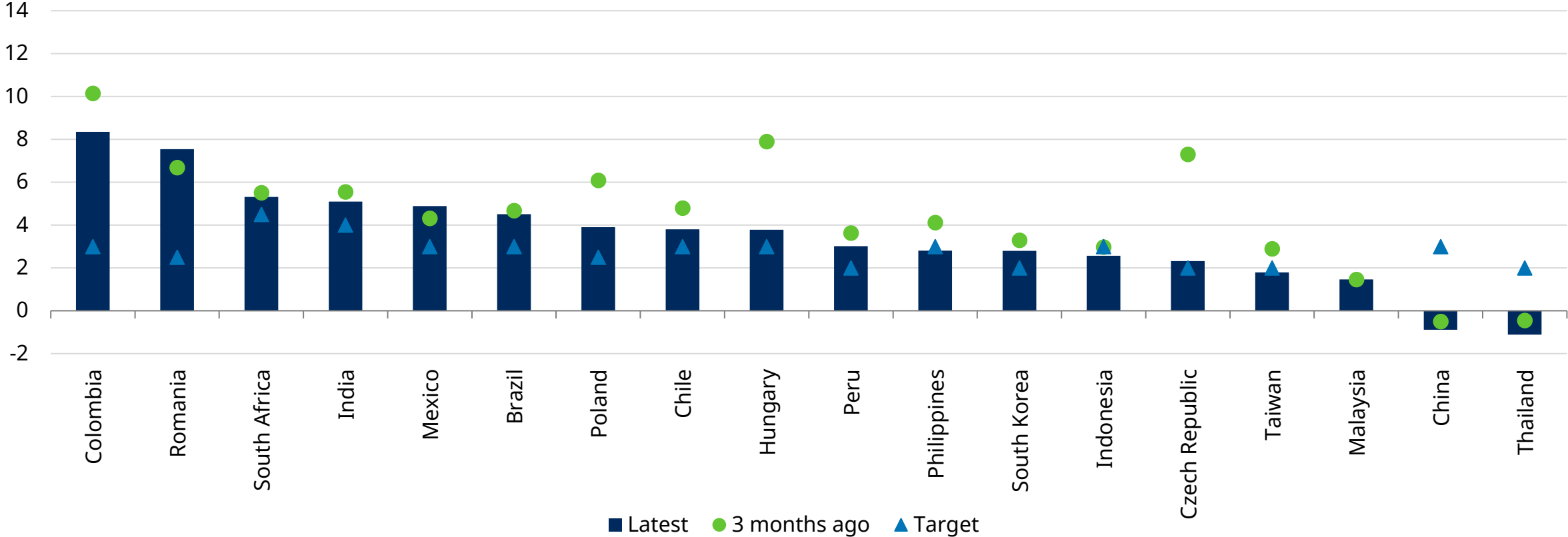
¹Based on 19 major EM countries. Turkey has very high inflation, with the annual core inflation at 73%. Despite large rate hikes, Turkey's policy rate of 45.0% is well below core inflation. Hence, Turkey's real policy rate is very negative at -28%, skewing the EM average.

Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Nominal policy rate minus annual core inflation. Please see relevant disclaimers on page 43.

Headline inflation at or moving towards target in most EM

China and Thailand are notable exceptions where inflation is below target

Headline inflation (%)

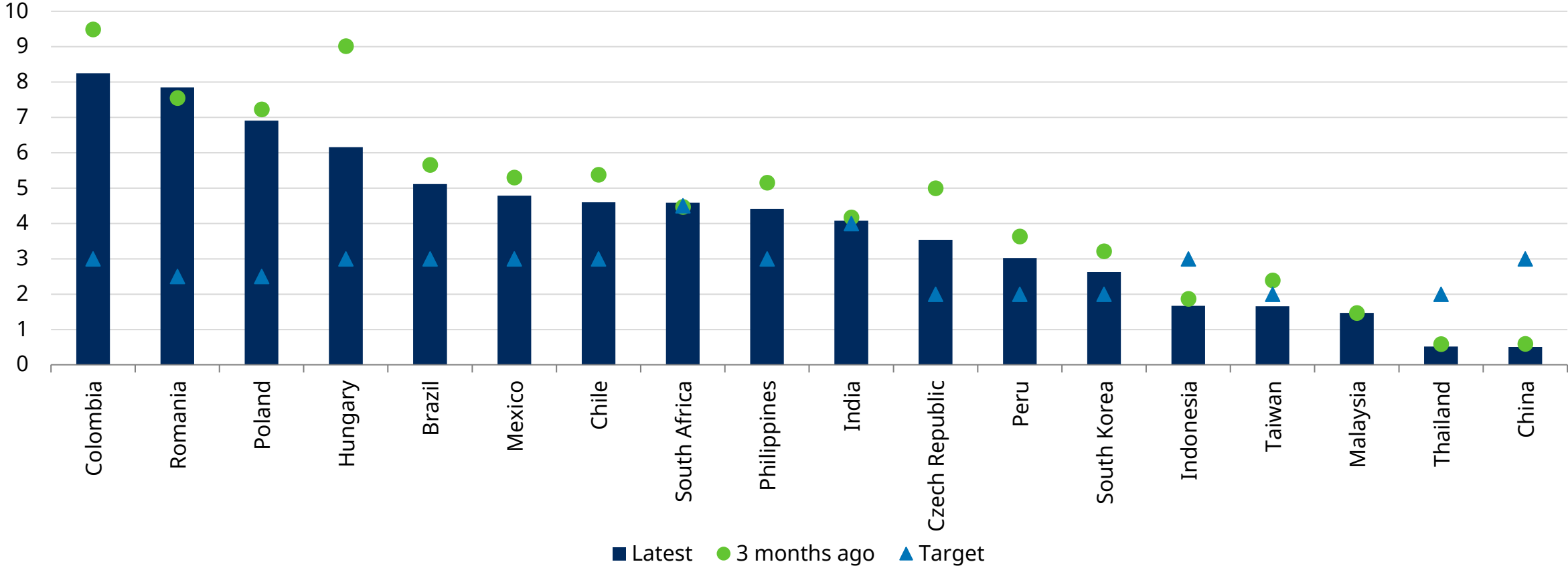


Turkey's annual headline inflation (67%) omitted from the figure.
 Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

Core inflation is also falling in most EM

Core inflation in China, as well as in Thailand and Indonesia, is below target

Core inflation (%)

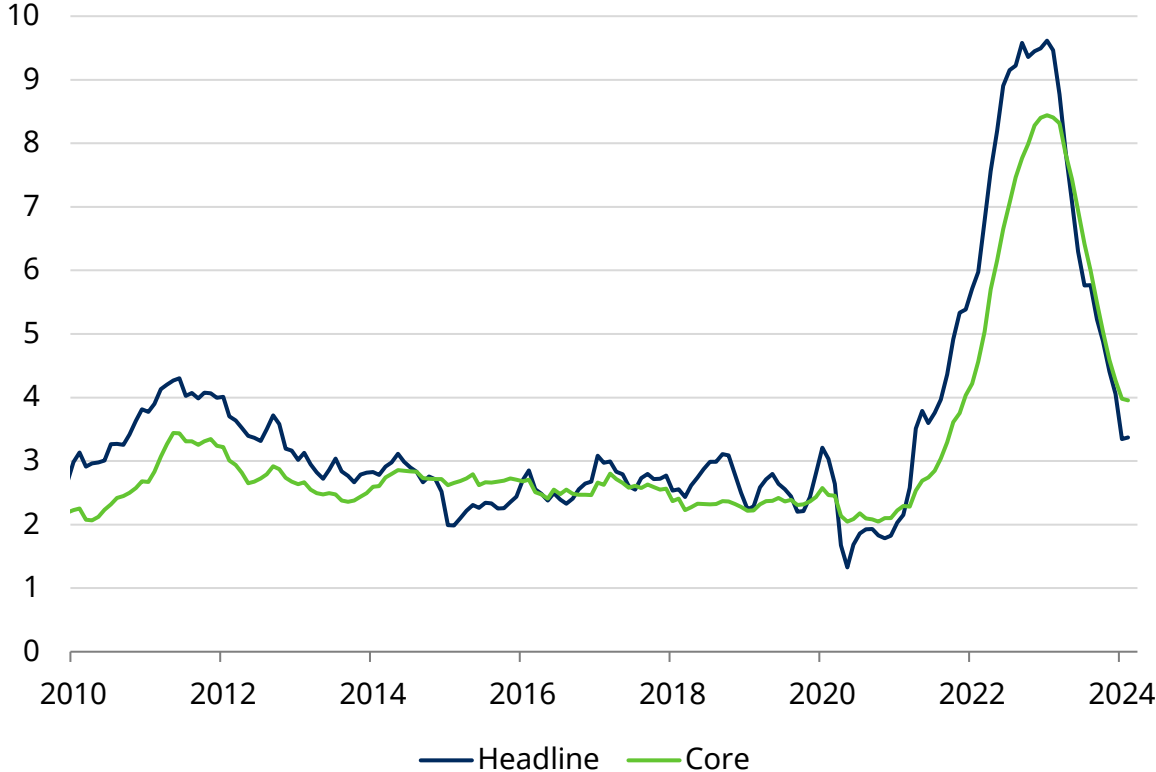


Turkey's annual core inflation (73%) omitted from the figure.
Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

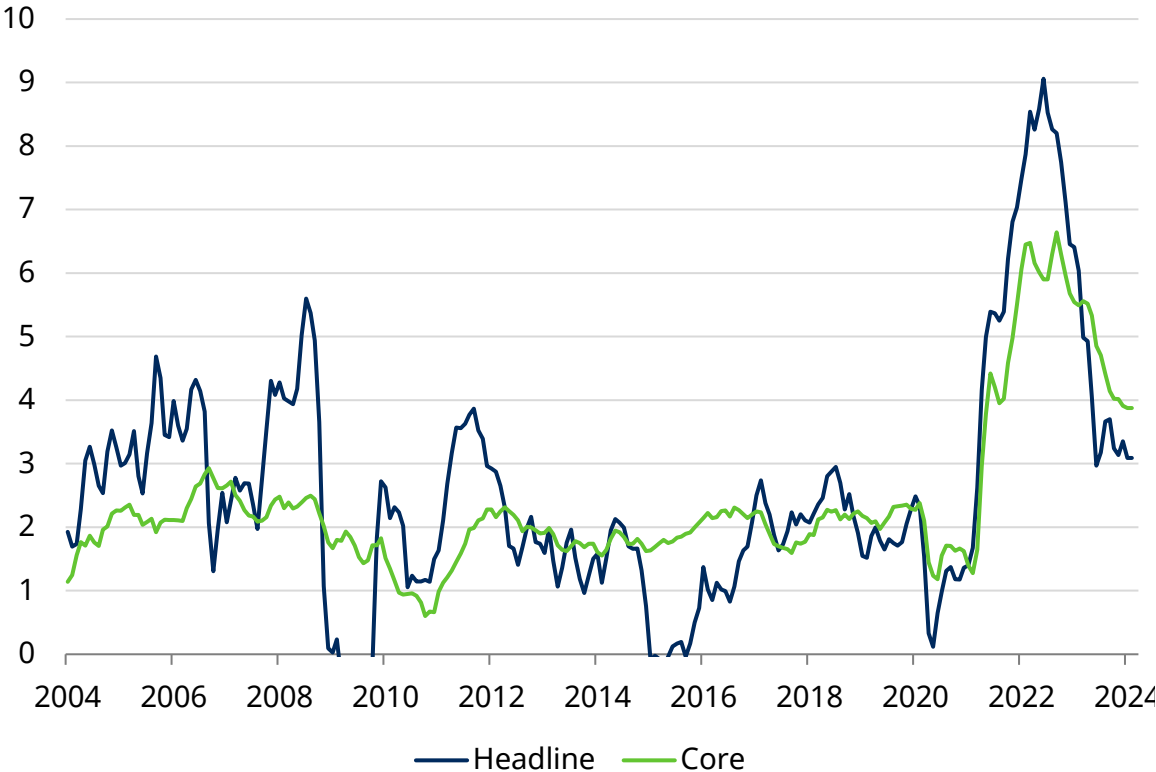
Headline and core EM inflation have fallen significantly

...but remain above the range seen over the last decade

Average EM inflation ex Turkey¹ (%)



US inflation (%)

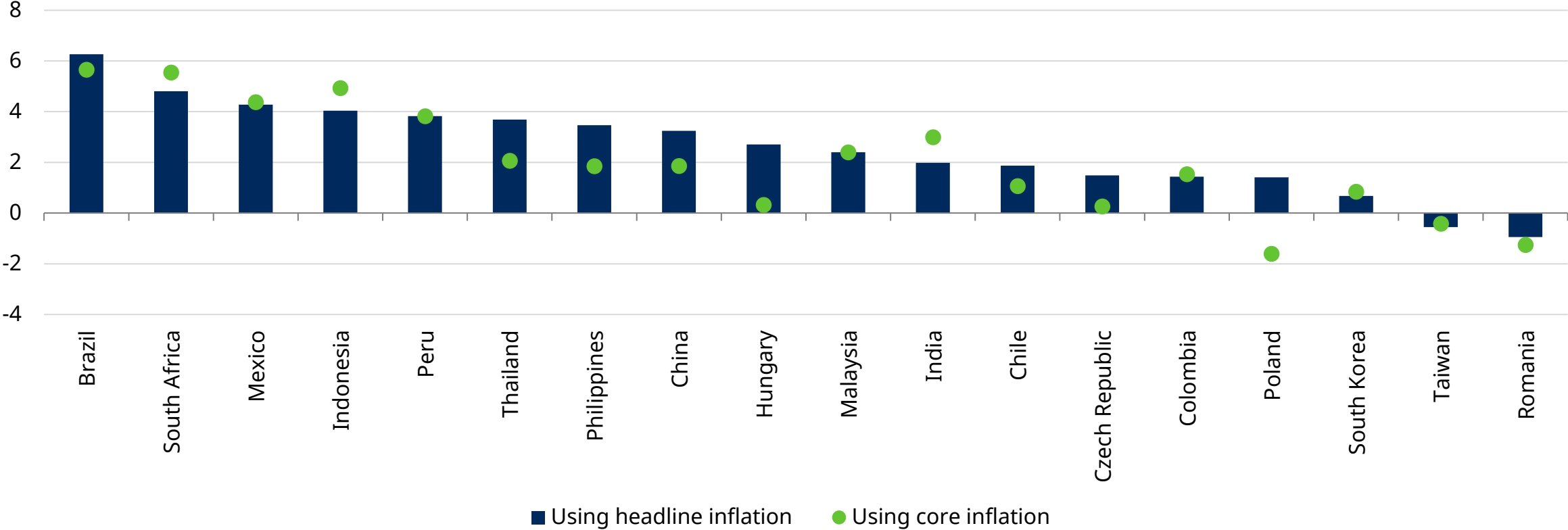


¹Based on 19 major EM countries. Turkey excluded because of significantly higher inflation in the country compared to the rest of the EM. Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

Real bond yields are positive in most EM...

Romania and Taiwan are the exceptions

Real 10-year yield

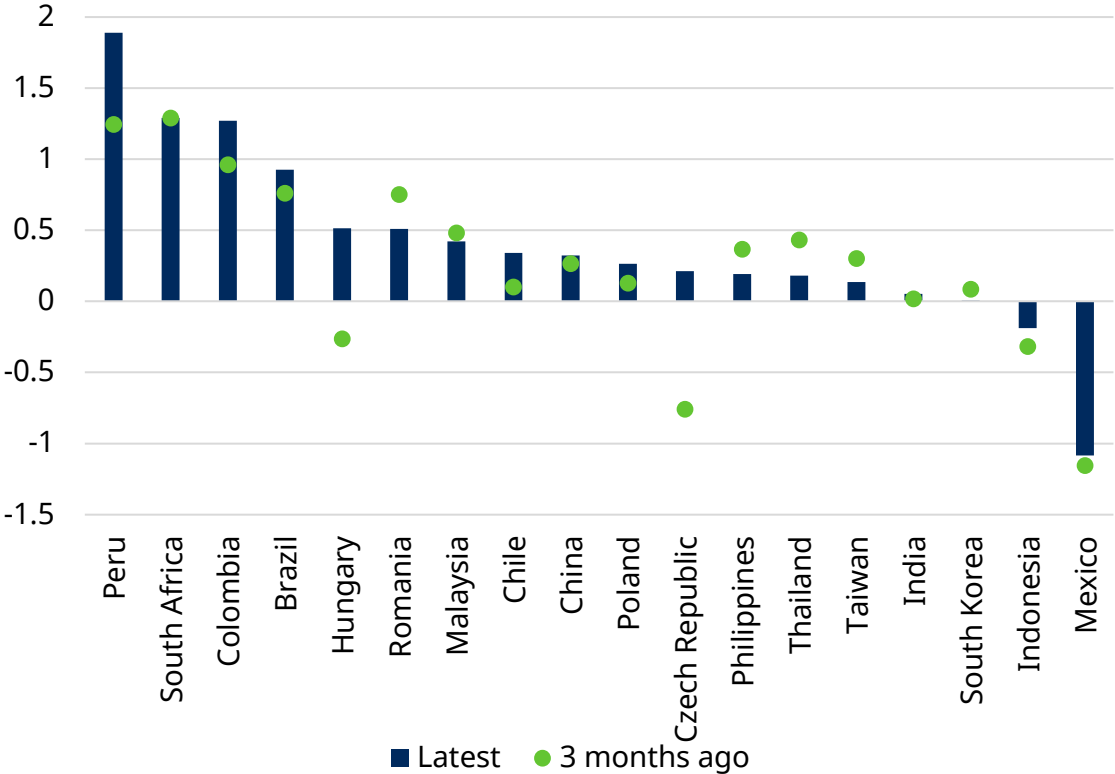


Real bond yields are highest in Brazil, South Africa, and Mexico

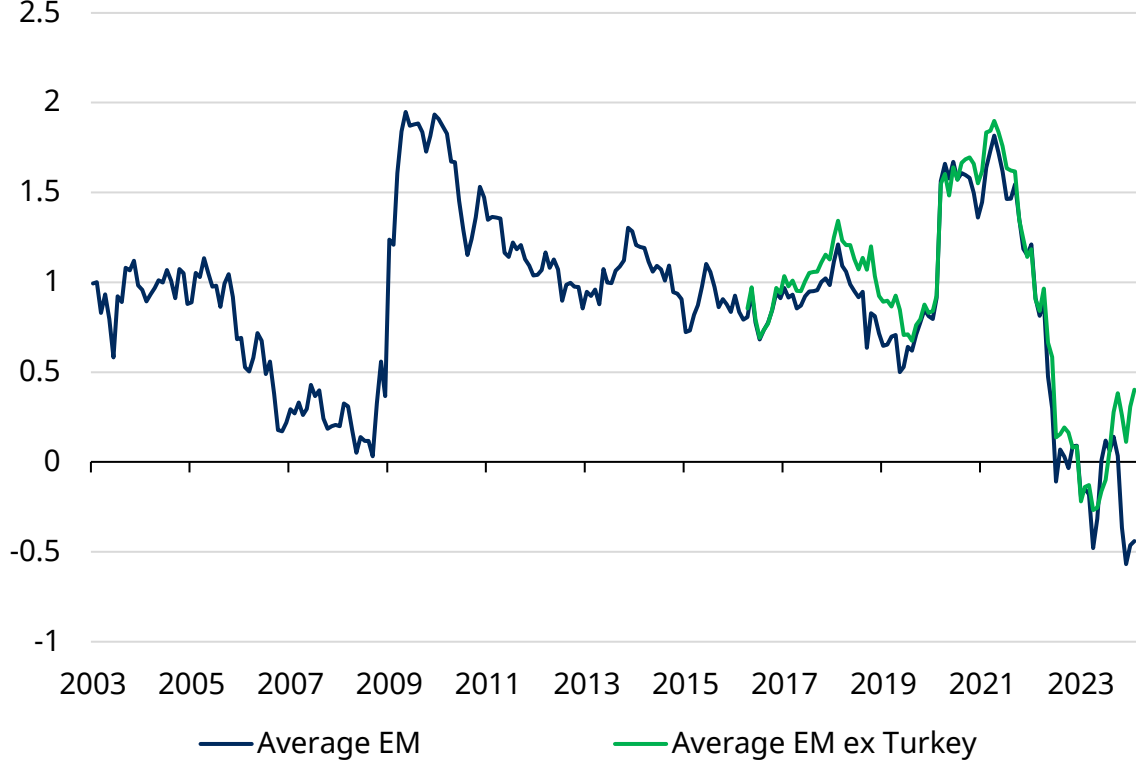
Nominal 10 year yield minus annual headline or core inflation. Turkey's real 10-year yield (-40% using headline inflation and -45% using core) omitted from the figure. Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

EM yield curve shape

Yield curve steepness (10y yield – 2y yield)



Average EM yield curve steepness (10y yield – 2y yield)¹



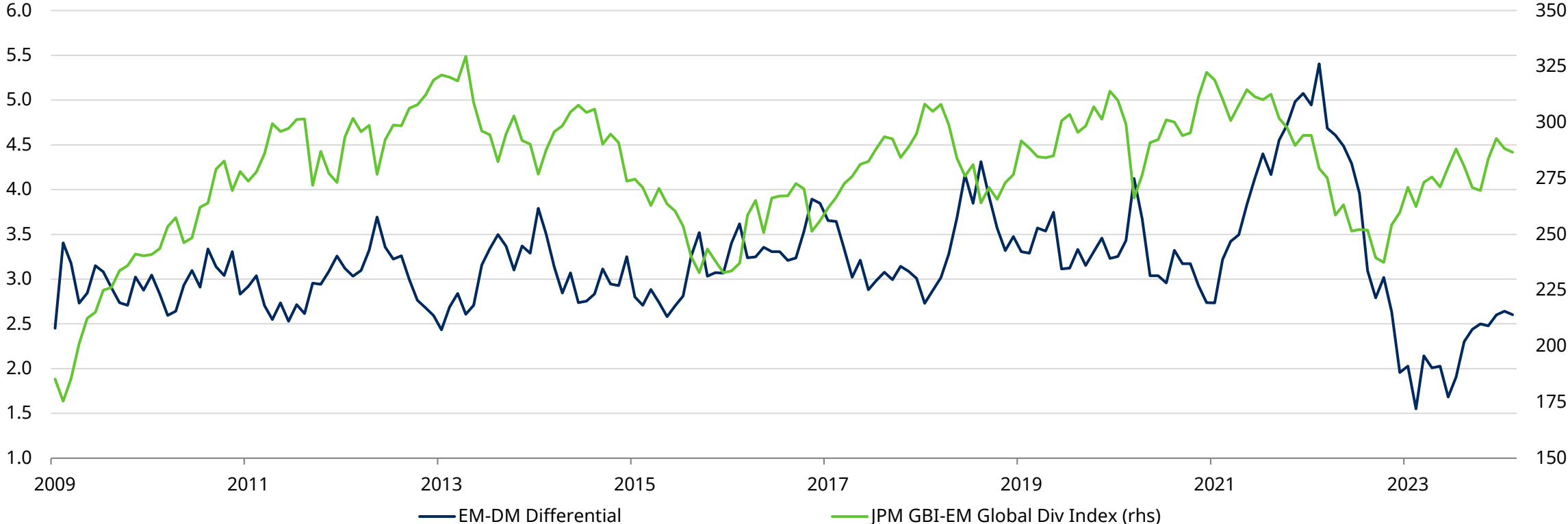
The average local EM ex Turkey yield curve is no longer inverted

¹Based on 19 major EM countries. Turkey omitted from chart on left due to degree of inversion – latest yield curve steepness is -11.6 percentage points. Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

Real yield differential has moved off long term lows

EM local currency bond valuation

EM-DM real yield differential (%)



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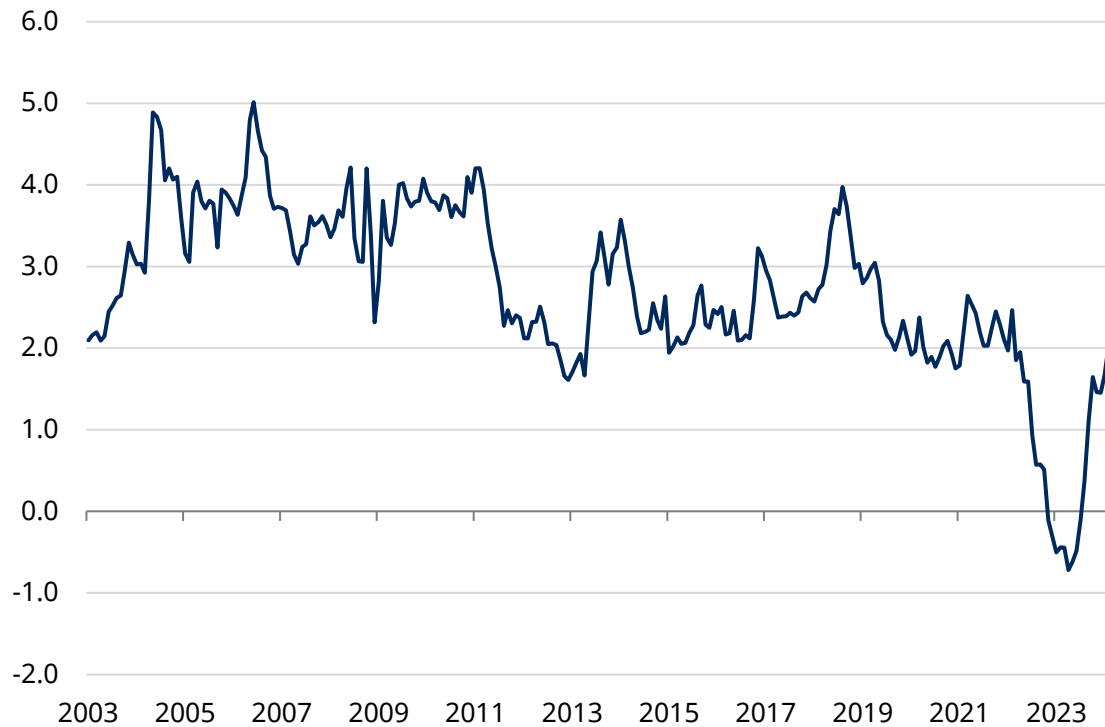
EM real yield is weighted average of individual JPM GBI-EM index nominal yields deflated by core inflation. DM real yield is 5Y government bond yields of US, UK, Euro zone, Japan deflated by core inflation, weighted by the size of individual government bond market.

Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

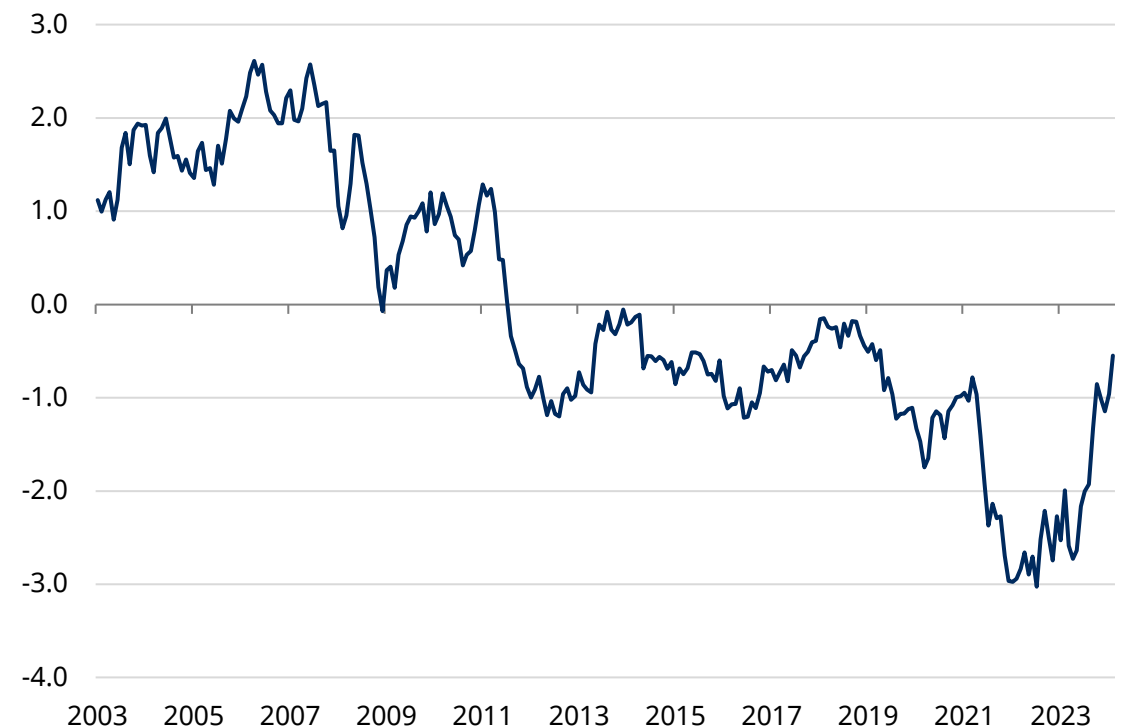
Average EM and DM real yields have picked up

Individual drivers of the real yield differential

EM real yield (%)



DM real yield (%)



Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 29 February 2024. EM real yield is weighted average of individual JPM GBI-EM index nominal yields deflated by core inflation. DM real yield is 5Y government bond yields of US, UK, eurozone, Japan deflated by core inflation, weighted by the GDP PPP of each country. Please see relevant disclaimers on page 43.



Emerging market currencies

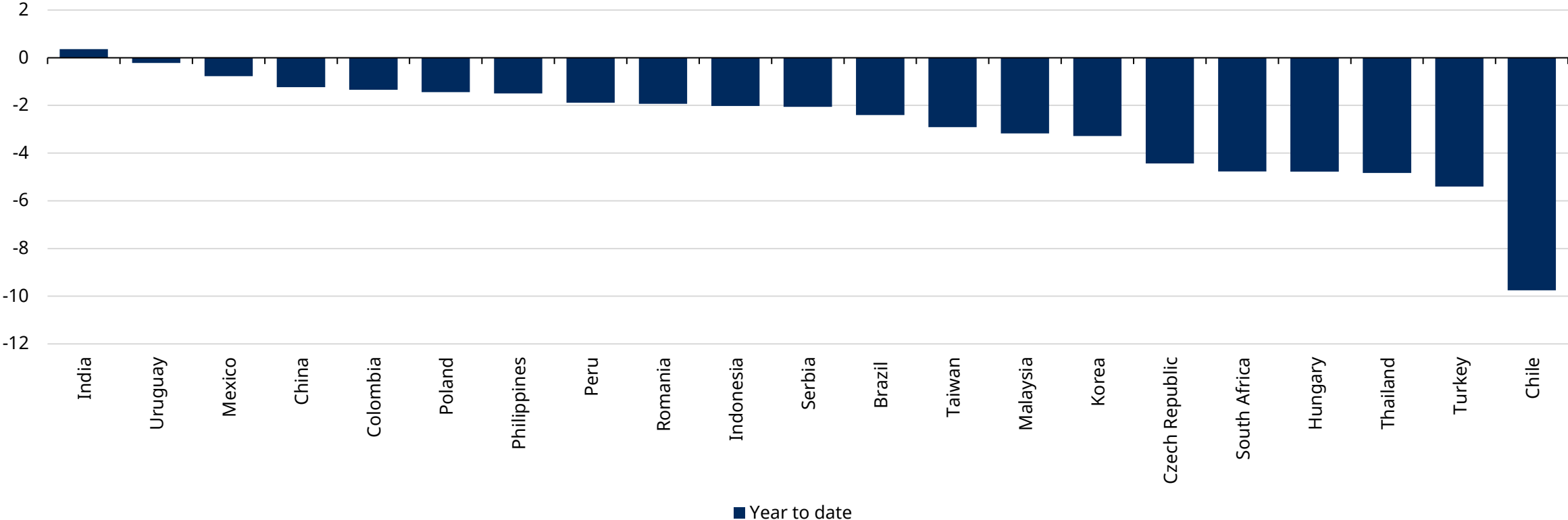
Summary: emerging market currencies

- EM currency performance versus the US dollar has been broadly weak YTD. Indian rupee is the only currency to eke out a positive return year-to-date. By contrast, the Chilean peso has been the weakest YTD.
- There are undervalued currencies in all three EM regions, though the degree of value in EM currencies varies significantly.
- The Czech koruna is notably above its long term and five-year averages. Currencies in Uruguay, Romania and India are also expensive versus history. Turkey, South Africa, and Malaysia are among the cheapest EM currencies relative to the long-term average.
- EM FX carry, the strategy of buying higher-yielding EM currencies against lower-yielding currencies to earn the interest rate differential, is at a multi-decade low.

EM FX broadly weak YTD

EM currency performance vs. US dollar

EM currency returns (%)



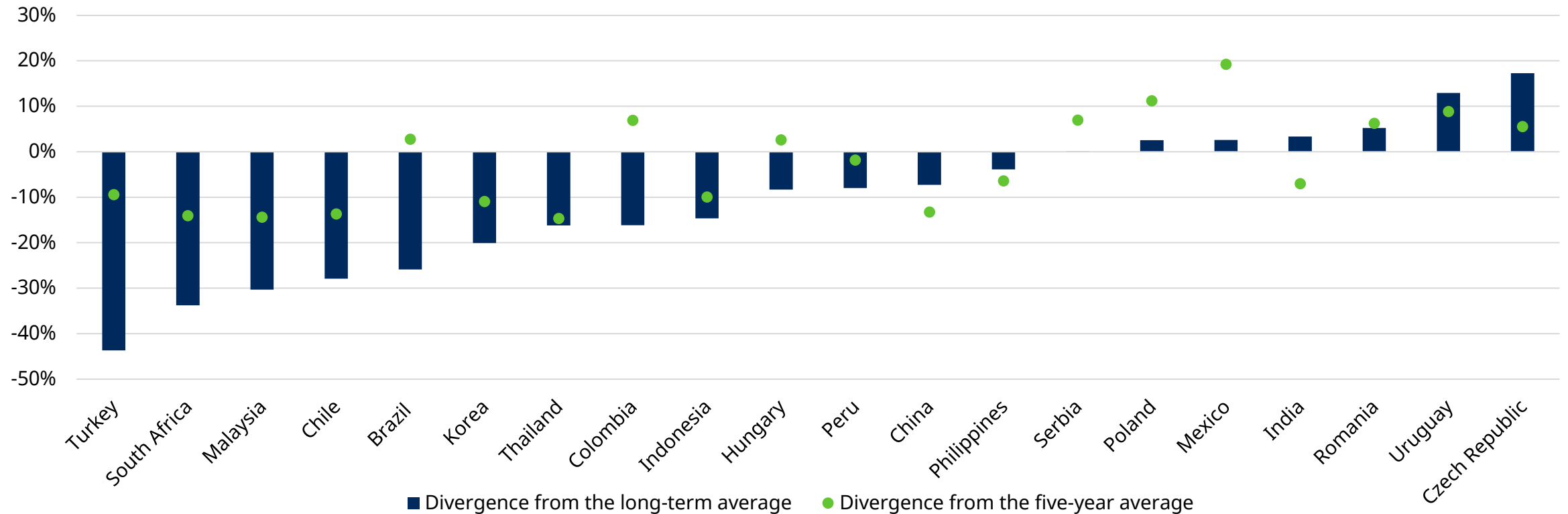
Indian rupee the most resilient EM currency YTD; Chilean peso the weakest

Past performance is not a guide to future performance and may not be repeated. Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

Some currencies are significantly undervalued

Notably EMEA and Latin American currencies

Real exchange rate: deviation from average



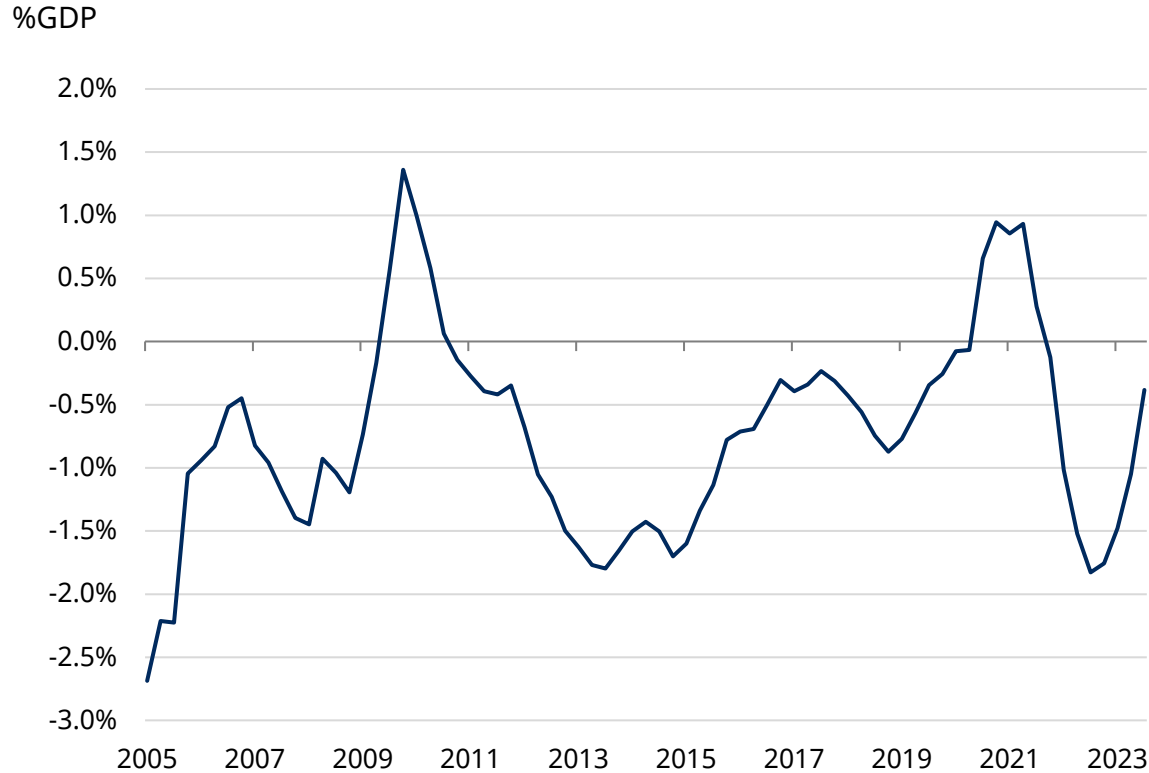
Turkey, South Africa and Malaysia are among the cheapest currencies; Czech Republic, Uruguay, and Romania have real exchange rates above the long-term average

Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Real exchange rate is the nominal dollar exchange rate deflated by the consumer price index (CPI) of each EM country vs. US. Long-term average is since January 1995. Please see relevant disclaimers on page 43.

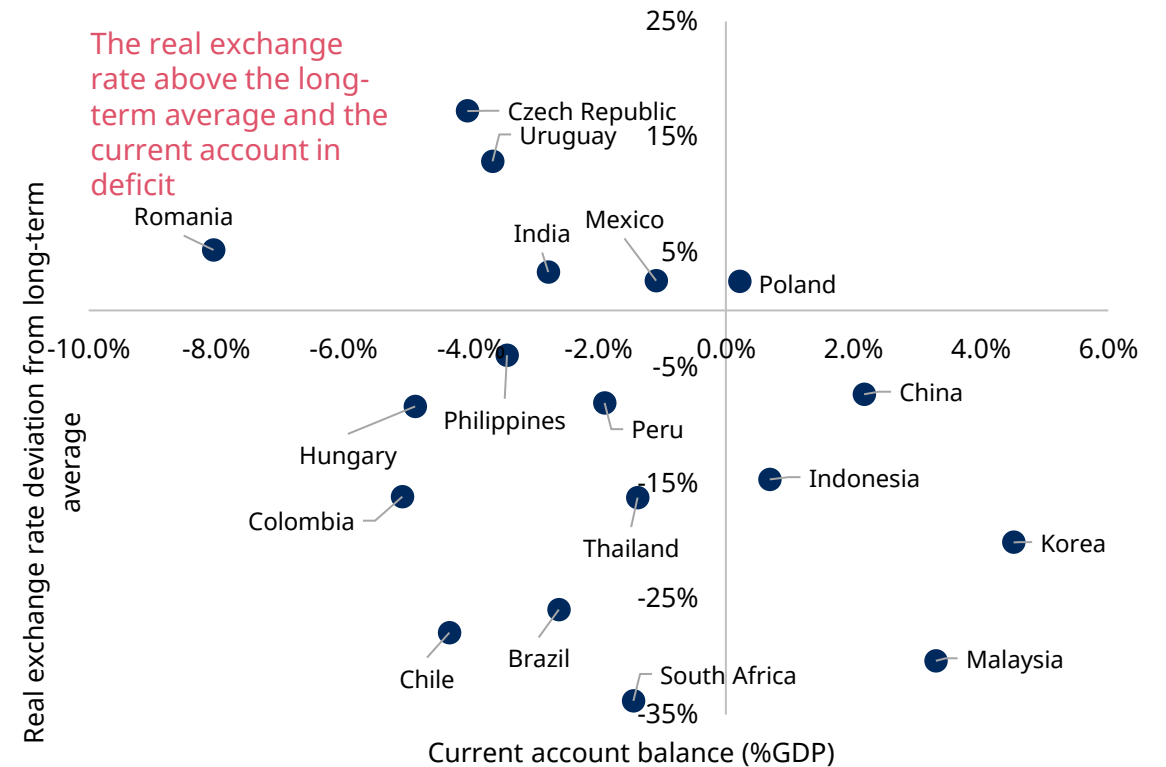
EM fundamentals: current account vs. currency valuation

Romania, Czechia, and Uruguay are among most vulnerable to currency weakness

Average EM current account balance¹



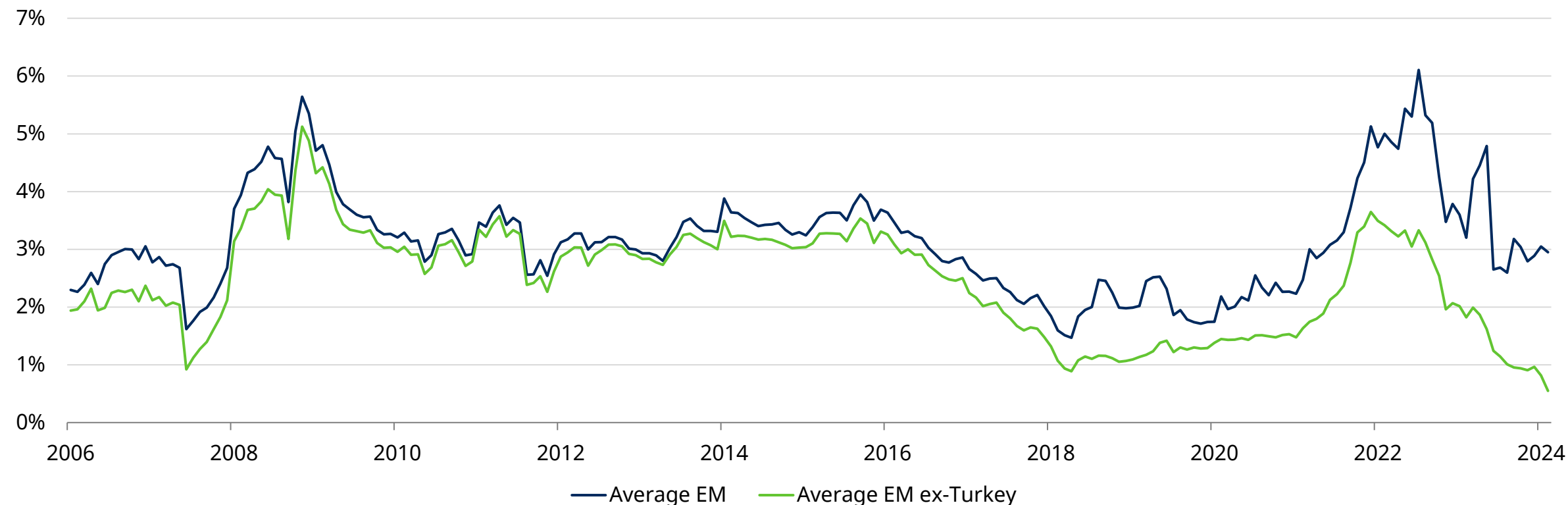
EM currency value² vs. current account balance



¹Based on the historical country weights of the JPM GBI-EM Global Diversified Index. ²Currency value is the deviation of the real exchange rate from the long-term average since 1995. Source: Schroders, LSEG Datastream. Current account data as at Q3 2023, currency value data as at 29 February 2024. Please see relevant disclaimers on page 43.

The EM FX carry trade made a comeback on the back of EM rate hikes but has faded

Average EM carry¹



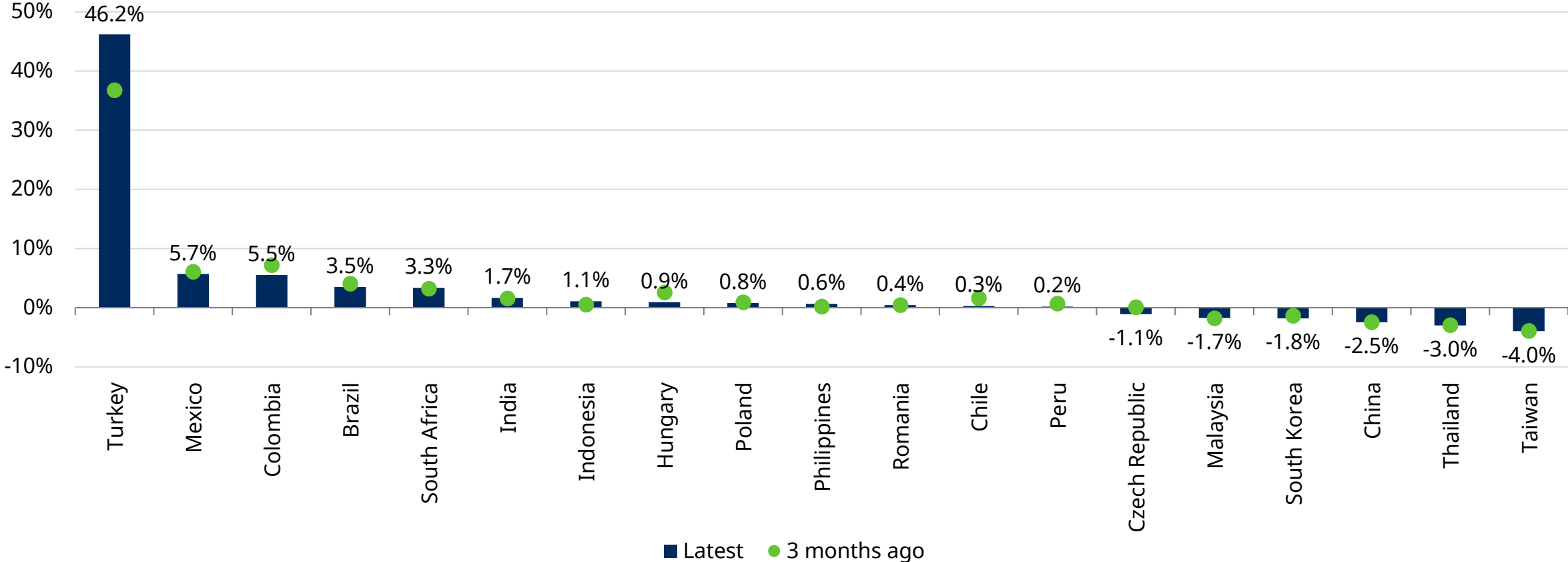
Average EM ex-Turkey carry is at multi-decade lows

¹The return of holding 1-year FX forward vs. US dollar to maturity. Based on 19 major EM countries.
Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

FX Carry varies significantly between the countries

FX carry trade in Turkey has picked up over the past 3-months

EM nominal FX carry¹



¹The return of holding 1-year FX forward vs. US dollar to maturity.
Source: Schroders, LSEG Datastream. Data as at 29 February 2024. Please see relevant disclaimers on page 43.

List of indices

- **Sovereign EMD** – The JPM EMBI Global Diversified Composite Index
- **Corporate EMD** – The JPM CEMBI Broad Diversified Index
- **Local EMD** – The JPM GBI-EM Global Diversified Index
- **US IG** - ICE BofA US High Yield Index
- **US HY** - ICE BofA US Corporate Index

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